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REFORMING THE REGULATION OF THE GOVERNMENT–SPONSORED ENTERPRISES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

THE PROBLEMS RELATED TO GSE ACCOUNTING POLICIES AND PRACTICES, INTERNAL CONTROLS, CORPORATE GOVERNANCE, AND CORPORATE CULTURES AND TO CONSIDER IMPROVEMENTS TO THE REGULATORY SYSTEM

THURSDAY, FEBRUARY 7, 2008 AND THURSDAY, MARCH 6, 2008

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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C O N T E N T S

THURSDAY, FEBRUARY 7, 2008

WITNESSES

REFORMING THE REGULATION OF THE GOVERNMENT-SPONSORED ENTERPRISES

THURSDAY, FEBRUARY 7, 2008

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order.

This morning's hearing is entitled "Reforming the Regulation of the Government-sponsored Enterprises," and while this is the first meeting on this topic in the 110th Congress, I want to acknowledge that the Committee has established a very substantial record on these issues, which was developed through a comprehensive series of hearings organized by my colleague and friend, the former Chairman, Senator Dick Shelby, when he was Chairman of the Committee. He has shown important leadership on this issue, and I want to acknowledge that at the very outset of all of this.

I want to acknowledge as well Senator Tom Carper's strong interest in this issue. Hardly a day goes by when Tom Carper has not asked me when we are going to deal with the GSE issues. And Jack Reed, of course, I want to mention this in a moment, the issue as well on the affordable housing issues and the like. There has been a lot of interest in the Committee on the subject matter.

Because we have a number of Members that are new to this Committee, I think it would be useful to remind people of the backdrop on these issues. A pattern of serious abuses and irregularities surfaced at Fannie Mae, Freddie Mac, and the Federal home loan banks starting in the year 2003. These entities misstated their incomes by billions of dollars and exhibited serious problems with their internal controls, accounting practices, and corporate governance. Today, Fannie, Freddie, and the Chicago Home Loan Bank are still operating under regulatory agreements.

It is because of these very serious problems that we all agree that a new world-class regulator with broad powers like those of the banking regulators should be created to oversee GSEs. By the same token, we need to recognize the tremendous benefits that the GSEs have brought to the American people, to our communities, and to our economy.

For example, the widespread availability, nearly unique in the world, of a 30-year, fixed-rate, payable mortgage is due in no small part to the existence of Fannie Mae and Freddie Mac. As a result, millions of Americans have achieved the dream of safe and stable homeownership that would otherwise have been out of their reach, in my view. This homeownership has been an engine of wealth creation for our Nation, wealth that is measured in the hundreds of billions of dollars, wealth that homeowners may use to pay for a child's college education, to finance a secure retirement, or simply to get them over a financial rough patch. Fannie and Freddie are two of the key drivers of the housing finance system that has created this wealth.

Now, let me be clear. I will not be one to preside over a legislative process that dismantles this system. I will pursue GSE legislation, and I will do so aggressively. But I will not do anything that undermines the foundations of this highly beneficial system.

Ironically, we have sat through hours of hearings over the years with witnesses repeatedly raising alarm bells about the risks Fannie and Freddie pose to the financial system. Yet today, the only part of the housing finance system where credit is still flowing is the GSE and FHA sectors. Everywhere else mortgage credit is either unattainable or incredibly expensive. One financial institution after another failed effectively to manage its risks and has been forced to seek capital infusions, often from foreign governments, to cushion their losses. Many financial institutions have gone bankrupt, but only after making bad loans have they turned the American dream into a living nightmare for millions of our hard-working fellow citizens. In short, the system is under siege, and it is the GSEs that are riding to the rescue.

I would note the second paragraph of Mr. Lockhart's testimony this morning in his opening statement makes that point very, very clear. As you point out, Mr. Lockhart, in your statement, but for the GSEs today, this problem would be a far more pronounced and serious one, and I thank you for that opening statement because it makes the point that I am making here. I will not bother reading it, but suffice it to say that that second paragraph states the case very clearly.

I know that there are some who take a very different view of this matter. Many are philosophically opposed to the very existence of these entities. Former Chairman Alan Greenspan told this Committee very frankly that he was in this camp and that he favored privatization. In my view, it is time to get beyond this stale ideological debate. We need to get down to the hard work of crafting a balanced bill that will create the kind of regulator that we all agree is needed. By doing so, we will ensure the public that a credible regulator is on the job, increasing confidence in our system. We will also be able to demand as an integral part of the process that the GSEs strengthen and deepen their commitment to affordable housing.

Senator Jack Reed of Rhode Island has provided a framework for doing just that, and I commend him for it. I intend to work closely with him going forward on that issue.

In addition, I believe the GSEs need to do more to help subprime borrowers get out of the abusive subprime loans and into the safer, more affordable stable products. Indeed, as Fannie and Freddie successfully address their accounting and management problems, I think it would be very helpful for them to devote a portion of the surplus capital they have been required to maintain for the purchase and workout of these troubled loans.

As my colleague Senator Schumer noted last week, these are the times when GSEs must live up to their public obligations, and I intend to put them to the test on this.

Before I recognize the Ranking Member, I want to reiterate that we are in agreement in many areas, and I look forward to working with him, with our colleagues on this Committee, with our witnesses, and with other stakeholders to produce a strong, broadly balanced, and effective piece of legislation. The American people are looking for us in these uncertain times to act. We do not have the right to disappoint them, and I do not intend allowing that to occur.

So we are going to move and move carefully with balance, without rigidity, but also understanding these are very, very critical times. Very critical times. And how we act, not only the pace of how we act, but what we produce is critically important for the well-being of our Nation. And I intend to see that we do that.

So, with that, let me turn to Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. Thank you for calling this hearing. At the outset, I also want to acknowledge—you acknowledged the work of some of the other Senators, but Senator Hagel, Senator Crapo, Senator Dole, and Senator Martinez, the former Secretary of HUD, along with Senator Sununu, have been very involved with all of us on trying to reform GSEs and make them work.

I remain committed, Mr. Chairman, to seeing this Committee create a new regulator with the authority and independence necessary to ensure that these institutions carry out their mission in a safe and a sound manner. While it is easy to recognize the role the GSEs play in providing liquidity to our home mortgage markets, I believe it is also important for us to recognize the size and scope of their operations. The combined obligations of Fannie Mae, Freddie Mac, and the Federal home loan banks exceed $6 trillion. That is over $1 trillion more than the $4.4 trillion publicly held debt of the U.S. Government.

Think about it a minute. Additionally, Fannie Mae and Freddie Mac are among the largest participants in the derivatives market, arising from their need to hedge the risks associated with their combined $1.4 trillion portfolios. Through their debt exposure in derivative contracts, the GSEs affect an extensive network of financial institutions. Clearly, these are large organizations with a tremendous influence on our financial markets. Should a GSE be unable to meet its obligations, the ramifications for our mortgage market and our financial system could be devastating. The current difficulties in the subprime market would be small in comparison if one of the GSEs were to falter.

Mr. Chairman, you have heard me say here many times that an institution that is well managed, well regulated, and well capitalized is not only likely to be safe and sound, but is also in the best position to weather bad economic conditions. We know that. Both

Fannie and Freddie have had significant management problems, as evidenced by a string of disturbing accounting scandals, which are not yet entirely resolved. They are not well regulated because the structure and the authorities of the current regulator are grossly inadequate to ensure the safe and sound operation of institutions the size of both Fannie and Freddie.

Finally, Fannie Mae and Freddie Mac are not well capitalized, as we know. Roughly 3 years ago, OFHEO placed a 30-percent excess capital requirement on the GSEs' statutory minimum capital requirements because of serious operational deficiencies. While a 30-percent surcharge may sound like a significant increase, let's put it in perspective. The practical effect is that their capital went from 2.5 percent—2.5 percent capital—to 3.25 percent for assets. In the wake of their combined losses of over $8 billion this year alone, representing almost 20 percent of their capital, both Fannie Mae and Freddie Mac are leveraged over 80:1 on a fair value basis—80:1. These margins leave little, if any, room for error. Even a minor decline in the value of their assets or higher than anticipated losses on guaranteed mortgage-backed securities could leave Fannie and Freddie ill-equipped to perform the necessary liquidity role in today's troubled housing market.

Considering that housing market analysts are uniformly forecasting further price declines, and some are even suggesting home values may decrease by as much as 25 percent next year, I believe it is only prudent to ensure that the GSEs are properly capitalized.

While we may ask the GSEs to perform the critical task of adding liquidity to the market, I believe we must also be cognizant of the fact that the GSEs face the same heightened risk as every other participant in the mortgage market. We have already seen some of the effects in the GSEs' bottom lines. In four of the last five quarters, Freddie has reported losses; Fannie has had two losses in the last five quarters. For the third quarter, the most recent public data, Freddie Mac reported a $2 billion loss while Fannie Mae reported a $1.4 billion loss. The fourth quarter is not likely to be any better, and 2008 promises to continue this trend for the GSEs and other market participants.

Today, as we find ourselves surrounded by waving red flags, what is the first thing we do? Do we look for ways to shore up the safety and soundness of these massive institutions by creating a strong and independent regulator? Do we look for ways to focus them on their original mission of facilitating affordable housing? Do we look for ways to decrease the risk profile of the GSEs so that we first and foremost protect the American taxpayer from another costly bailout?

The answer to all of these questions is no. We do none of these. In fact, we do quite the opposite. As part of the stimulus package, the Congress is considering an increase in the GSE conforming loan limit from $417,000 to over $700,000.

Let me repeat so that there is no confusion. The Congress is considering an increase in the GSE conforming loan limit from $417,000 to over $700,000. This represents a nearly 75-percent increase in the loan limit, despite the fact that this Committee has not held one hearing, has built no record, and has no clear picture as to the status of the jumbo market and whether it really needs this kind of help at this time.

So we are clear, an individual would need a yearly income in excess of $150,000 to even qualify for a $700,000 loan. Once again, instead of thinking of ways to further protect the American taxpayer, we are actually considering ways to further expose them for the benefit of those making healthy six-figure salaries. As one Member of this Committee who lived through the savings and loan crisis and its aftermath, as the Chairman did, the mood reminds me of the 1980 behind-closed-doors increase in the deposit insurance limit from $40,000 to $100,000.

Mr. Chairman, we must ask ourselves why the GSEs are regulated in the first place and let the answers drive the structure of their regulation. Fannie Mae and Freddie Mac are not regulated for the sake of protecting their shareholders or their debt holders from loss. They are regulated to protect the taxpayers and to protect the stability of our financial system.

I commend the hard work of Director Lockhart and his agency in making use of the limited tools at their disposal to monitor the GSEs. Mr. Chairman, I believe, however, that OFHEO lacks the necessary authority to protect both our financial system and the American taxpayer from significant loss in the event of a GSE insolvency. This deficiency becomes all the more striking as we consider increasing the conforming loan limits by nearly 75 percent without even entertaining some added protection.

The role played by the GSEs in our mortgage and financial markets is necessary, as you have pointed out. But what is equally necessary, I believe, Mr. Chairman, is the need to ensure the safety and soundness of their operations so that they continue to be a vital and dependable source of liquidity in our mortgage market. Therefore, I believe, Mr. Chairman, that we must craft strong legislation that will address the very real risks posed by the GSEs while at the same time facilitating and strengthening their core mission.

I hope we can work together on that goal.

Chairman DODD. Thank you very much, Senator Shelby.

Let me just ask our colleagues here, I want to go around and ask them for opening statements. It is a big issue and an important issue, but if you could try to limit them to a few minutes, this way we can get to our witnesses and so we will have a chance to hear them.

Let me turn, if I can, to Senator Carper. And I am, again, going to recognize people in the order in which they arrived here this morning.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thanks, Mr. Chairman. Thank you for bringing us together, and to our witnesses today, welcome. We look forward to your comments and your responses to our questions.

Like many of us gathered here today, I have been a strong supporter of GSE reform for a number of years. Fannie Mae and Freddie Mac are, I believe, the backbone of a mortgage market that is reeling from the subprime crisis. And as we have seen both this year and last year, subprime mortgages have destroyed the private-label mortgage-backed security market. It is almost as if a hole had been punched in a bucket and all of the liquidity in the mortgage market had drained out.

There are any number of reasons for the decline. This Committee has held hearings on the subprime mortgage market and the foreclosure tragedy. In order to bring liquidity back into the marketplace, we must use Government-sponsored enterprises. The Federal home loan banks have stepped up to this task already. Federal home loan bank advances have increased dramatically over the last year, from approximately $600 billion to some $900 billion. And while much of the news is focused on the $50 billion advances to Countrywide, this system has served many more institutions, and I will follow up with some questions later on that explore the risks associated with the concentration of advances to Countrywide.

The stimulus package currently pending before the Senate includes a provision to raise the conforming loan limit from Fannie Mae and Freddie Mac to $730,000, alluded to by Senator Shelby. This will certainly provide needed liquidity to the markets by expanding the mortgage-backed securities that are guaranteed against credit losses, to include mortgages much higher than the $417,000 limit under current law. And while this will help, it will also bring some added risks to these enterprises, and we must take steps to bring the regulator back into the 21st century.

You know, we have debated these issues over the years, and, unfortunately, at least to date, we have not resolved our differences. But we now have some serious challenges facing our economy, and this is the time to restore confidence in our mortgage markets. I look forward to working with our Chairman and Ranking Member and a lot of other folks around this table to find common ground on these issues.

Some of the issues we have argued over in the past have been overtaken by market events, and because time is of the essence, I would hope that we would use the House-passed bill as a starting point. And while I have some concerns about some of its provisions, it is a good middle ground, and we can build on the consensus reached by Chairman Frank, his Committee, and Secretary Paulson and others.

With that said, any bill that we debate should have the following key provisions: A new regulator with combined authority should be independent. A new regulator should be able to set minimum capital requirements. A new regulator should have enhanced enforcement authorities. SEC registration—Fannie on track, and I think all 12 Federal home loan banks have been registered now. New program approval. Affordable housing fund and goals should be included as well. And there should be limits on retained portfolio.

And while we are searching for ways to help a distressed marketplace, let's just keep in mind that there are $46 trillion of GSE securities currently in the market around the world, and we need to do everything we can to maintain the confidence in the GSEs and their security. The best way to maintain confidence is to create a regulator that would have the authority and the stature to calm the markets and ensure that both the debt and the mortgage-backed securities issued by our GSEs continue to be seen favorably by investors.

I would just close with this, Mr. Chairman. Go back 2 years ago. There was a whole lot that we disagreed on. And if you go down the list of things we used to disagree on, on which there is now consensus, we agree on a whole lot more today than we disagree on. And with that consensus, my hope is we will be able to move forward expeditiously. I am delighted that we are here and get this party started.

Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator Carper, very, very much. Senator Hagel.

Senator HAGEL. I will wait for the testimony.

Chairman DODD. Thank you, Senator.

Senator Reed, Jack Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you, Mr. Chairman. I have a written statement which I would like to submit to the record.

Chairman DODD. Done.

Senator REED. And I would make some very brief comments, I think.

First, we all recognize the crucial importance that the GSEs play in our financial system, particularly providing liquidity in our mortgage market at a time when that liquidity is desperately needed.

We also, I think, agree, based on everything I have heard this morning, that the GSEs need a strong regulator with a full panoply of powers as outlined by Senator Carper, and that is a good starting point.

As we go forward, Senator Shelby has suggested that we will consider allowing Fannie and Freddie to purchase jumbo mortgages. We have to do that carefully, and we also have to ensure they do not lose focus on the primary area of their concern, which is the moderate- and low-income market in the United States, to provide those individual Americans with access to mortgages and homeownership.

As the Chairman indicated, I have introduced, along with colleagues, the GSE Mission Improvement Act, and this would create an Affordable Housing Trust Fund. I think that has to be part of a final legislative GSE proposal. Sixty-five percent of the money would be a formula grant to States which, in the first year, could be used to go in and help people who are underwater with their mortgages by providing fixed 30-year mortgages rather than the exotic mortgages that are now plaguing their lives. The other 35 percent would be a capital magnet fund which would attract private capital for renovation, rehabilitation, and construction of affordable housing. We do understand that at some point going forward we have to get back into building affordable housing, not expensive housing exclusively.

And I think without our concentration on affordable housing for our citizens, we will continue to have significant problems. Many of the people that are troubled today because of mortgage difficulties, had they had access to not only affordable housing but affordable mortgage financing would not be in the terrible predicament they are in today. I think we can do more and we should do more.

I thank the Chairman and Senator Shelby for holding the hearing and their wise comments. Thank you.

Chairman DODD. Thank you very much.

Senator Martinez.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Mr. Chairman, thank you very much. I want to welcome the panel, very especially Ronald Rosenfeld, who I had the pleasure to work with while I was at HUD as he was Director of Ginnie Mae at the time.

Mr. Chairman, for a long time, I have been concerned about the role of the GSEs, and let me just say that I will put my full statement in the record and just make brief comments.

The concern arose during my time at HUD because of the great risks that the implied guarantee of the Federal Government presented a point of liability to our Government, while at the same time understanding the weakness of the current regulator. OFHEO and HUD share the regulation. It is not all under one roof. And in this bifurcation and without the independence and the enhanced powers that a regulator should have, OFHEO does not have the tools available to properly regulate these entities.

This is why it is critical that we do GSE reform. This is why it is critical that the time be now, because we are at a time of crisis in the housing market. We are at a time of crisis in the liquidity of mortgages in the housing market.

In order to have a strong regulator, we would not only be ensuring the safety and soundness, we would be giving a sense of comfort and security to the United States taxpayer, but also we would be enhancing the credibility of Fannie and Freddie and the other GSEs as a prudent place to invest money. It would increase liquidity into the housing market at a time when tremendous needs for liquidity exist.

So for my way, I think that the time has come. I think we need to move to ensure that the new product requirements be fully overseen, that there be a timely opportunity to object. The current regulator gets told when a new product goes into market. We have got to have a situation where, before a product goes into market, that it is brought before the regulator for an approval or disapproval in a timely way, because I know that the market shifts quickly. But, in any event, safety and soundness, new product approval, sticking to the charter mission, ensuring that it is about helping housing at a certain level of the marketplace.

I am very, very concerned about the current stimulus including an increase in the conforming loan limits. We are doing that without properly knowing and understanding the implications of it, the increased liabilities to companies that already are stressed at a time of difficulty. And I know there are good reasons why. The people in Miami would have an opportunity to get loans that they otherwise might not get. I am encouraged that this would be very limited in terms of markets where this would happen, but I am very concerned——

Chairman DODD. And in time, too.

Senator MARTINEZ. And time. Certainly in time. But it also ought to be coupled with a commitment, Mr. Chairman, that we will get

GSE reform, that we will not delay on this, because the two ought to be coupled together. Sure, there is a need for them to have increased loan limits in certain markets and for a period of time, but at the same time, we should not do so without a strong commitment to a strong regulator.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very, very much.

Senator Menendez.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman. Let me thank you and Senator Shelby for bringing us back to this incredibly important topic, and I look forward to your leadership in moving ahead on this.

Very briefly, the discussion of reform has largely come back to the forefront of the debate due to the discussion of loan limit increases in the economic stimulus package, and I want to pick up where Senator Martinez left off.

Let me say that I clearly support a temporary increase in the GSE loan limits. It will help restore liquidity to the market. It will increase confidence, make loans more affordable and available. It is an appropriate and necessary step to help get our economy back on track.

That said, looking forward, I firmly believe that it is time to pass a GSE reform bill. It is time to create a stronger, politically independent new regulator. I also believe that it is also time, once they have met the requirements of their consent orders, to move forward and not let the accounting scandals of the past define their future.

I have seen the great work that Fannie and Freddie have done in my home State of New Jersey. I know the vital role that they play in the housing community. Their mission to help low- and moderate-income families get affordable financing for a home has never been more critically needed than now in terms of the midst of this subprime crisis.

Millions of homeowners across this country are crying out for help. They are pleading for help in saving their homes, and today, on their behalf, we are asking you to help modify their loan terms. I know that you are already working toward this goal, and I simply hope you will continue to do so and that we use every resource possible to help these people keep the American dream and not have it become the American nightmare.

And with that we look forward to meaningful GSE reform as a critically important step for the longer term and the opportunity to do some of what you have suggested in the short term.

Chairman DODD. Thank you very much, Senator. And let me just say to all Members that their full statements will be included in the record.

Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman, and I want to state at the outset, in order to be brief, that I support the comments that many of my colleagues have made with regard to concerns about the increases in the loan limit in the stimulus package and the need for us to move forward with full GSE reform legislation, primarily to assure that we have a strong, independent regulator. I just want to highlight two issues, and then I will look forward to working with the witnesses.

First, one of the areas that I believe we need a lot more evaluation and debate on and vetting is an evaluation of the comparative strengths and weaknesses that exist between affordable housing goals, affordable housing programs, and an affordable housing fund. Fannie and Freddie have affordable housing goals. The Federal home loan banks have an affordable housing program. And the House-passed GSE reform legislation would establish a new housing fund with goals.

I think that we need to look at the—by the way, the most recent GSE reform legislation from this Committee did not have the housing fund, but I know there is now a very strong concern for including one.

Although I do not think there is much disagreement about the need to reaffirm the Government-sponsored enterprises' mission with regard to affordable housing, there is still a lot of debate about how this can best be accomplished, and specifically, we need to determine what is the appropriate amount of resources that should be allocated to these affordable housing issues, and who should allocate the funds, and how these funds should be best spent. I think that is a very critical issue as we move forward with regard to this legislation.

Another issue that I want to revisit is the question of the combining of the regulatory authority of all housing GSEs. I note that in Assistant Secretary Nason's testimony, he reaffirms the position that the Federal home loan banks should be included in the GSE reform and that we should have one independent regulator. I am going to be interested in evaluating the structural differences between Fannie and Freddie and the Federal home loan bank system to determine how we would accomplish that and still achieve the necessary purposes and objectives that we have for both of the different types of systems that we have to deal with there and whether it is the right decision for us to move to one combined regulator for all.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

Senator Schumer.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. Once again, thank you for holding this hearing and for your leadership on this issue of GSE reform, which has been long and steadfast. And, of course, we are in the midst of one of our Nation's worst housing crises, so it is especially important that we examine the critical role that GSEs play in providing liquidity and stabilizing the housing market.

But rather than focus exclusively on the specific issues of GSE reform that we have discussed many times in the past, I would like to examine the role that GSEs can and should play in these times.

As this Committee has worked on this issue over the past several years, as you well know, I have been one of the strongest supporters of the enterprises. Fannie and Freddie were created to provide liquidity to the Nation's mortgage market and to ensure that a steady supply of mortgage credit is available in all market conditions. In the past, they have done a stellar job. Fannie and Freddie have served our country well. They have created unique products that could not have been developed by purely private or purely public sector companies. This ability strengthens and fills a gap in the housing markets.

However, during the housing market disruption, Fannie and Freddie have not lived up to my expectations and those of many others when it comes to assisting borrowers who are having difficulty affording their loans. Instead of leading the charge to help troubled borrowers, we have had to push them forward every step of the way. As Government-sponsored enterprises, Fannie and Freddie fill a special need. However, in this time of our greatest need in the housing markets since we have recovered from the Great Depression, I have been disappointed by their response.

The conforming loan limit increase, which the enterprises have sought for many years, will be a significant and profitable new business for Fannie and Freddie, and I expect that in return for allowing the enterprises to enter the jumbo market, the companies will make a commitment to fund additional refinancing or modification resources to lower-income borrowers who are having difficulty affording their payments.

While Fannie and Freddie have developed new products and increased their rate of securitization to date, I am increasingly concerned by statements from the companies and from their regulator that additional action will be difficult or impossible because of capital constraints and market conditions.

Let me be clear. This is not an acceptable response. These organizations were created specifically to help in times of crisis. It would be like calling the fire department to put out a raging fire and have them tell you they were busy getting a cat out of the tree. That is what they have always done, and that is what they want to keep doing. If capital constraints are restricting action by the GSEs, they should consider raising additional capital, and OFHEO and Congress should consider ways to give them additional flexibility to help their subprime borrowers.

One option is to re-examine the 30-percent capital surcharge imposed in the wake of the accounting scandals at Fannie and Freddie. If, as expected, the companies become timely filers in February, OFHEO should consider reducing the enterprises' capital surcharge, if that can be done in a safe way.

Any capital relief has to come with a substantial new commitment to purchase loans for struggling subprime borrowers. If Fannie and Freddie will not enter this agreement voluntarily, we should consider imposing it as part of the agreement to lift the capital surcharge. If the debt markets are not allowing the GSEs to borrow as cheaply as they once could, that is how the world works, the capitalist world works. They still enjoy advantages that no purely sector actor has, and, thus, they have a responsibility to use those advantages to provide liquidity and stabilize the markets. To simply maximize profitability and say we are not going to help because there are other things we do that are more profitable is not acceptable in these very critical times.

So I am calling on their CEOs today, Fannie and Freddie's CEOs, to continue to improve the GSEs' response to the crisis and make a renewed commitment to help struggling borrowers. Although market conditions may not be ideal to maximize the GSEs' profit, their role in these conditions is to step in where the private market will not and ensure continued liquidity for the mortgage market.

The GSEs also need to be industry leaders when it comes to other aspects of the market. Yesterday, I wrote to both enterprises to urge them to clarify mortgage servicing standards for outside servicers. Because Fannie and Freddie represent such a large share of the market, their servicing guidelines create a de facto industry standard that prevents servicers from performing principal writedowns—a critical type of loan modification that will help many homeowners during the housing crisis, especially those trapped underwater in their loans.

The clarification of these standards would be a simple and prudent step by the GSEs to show their commitment to help at-risk homeowners during these troubled times. If Fannie and Freddie had the right proactive attitude, I would not have had to write letters to Fannie and Freddie imploring them to set clear and high standards for loan servicing. These companies operate with an implicit Government guarantee, are exempt from paying State and local taxes, and are able to borrow at reduced rates. With these advantages come responsibilities. I think many of us expect these organizations to be in the vanguard of efforts to help borrowers, especially in times of crisis. They should be proactively looking for ways to improve all aspects of their business, from subprime refinancing products to their purchasing commitments, to their loss mitigation and loan servicing guidelines.

Mr. Chairman, I have some other things I wanted to say to Mr. Rosenfeld and what I feel is the lack of response, particularly in regards to Countrywide, but I will ask—in the interest of time, I will put that statement in the record and save it for questions.

Chairman DODD. Thank you, Senator, very, very much. And before you came in, I made the point, to pick up on your point here, regarding the lifting of the capital surcharge. I would like to see that money stay there so they start utilizing that close to $20 billion that is there specifically to do exactly what you have talked about, and that is, to assist those people who are struggling, to keep them in their homes. That is exactly the role that Fannie and Freddie I think could play at this critical time.

Senator SCHUMER. Thank you, Mr. Chairman.

Chairman DODD. Hardly going to be enough, I might point out. I think more is needed. But that would be one wise use of that capital.

Senator SCHUMER. I could not agree more. Thank you.

Chairman DODD. Senator Dole.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Mr. Chairman. I certainly want to welcome our witnesses today. Director Lockhart and I have worked together in the past when I was serving as Secretary of Labor and he was heading the PBGC, and I thank you for your service to our country.

As you know, the GSEs have been of particular concern to me and for many of the Members of this Committee. I appreciate the Committee's careful attention to this matter today, particularly in light of the current housing and financial unrest.

Originally, Fannie Mae was created in 1938 as an agency of the Federal Government, fully backed by the U.S. Treasury Department. Its intent was to increase affordable housing options for Americans. Fannie created a secondary market for home mortgage loans at a time when we all know our Nation's housing market was in a period of dire straits. In 1970, Congress charged Freddie Mac with a similar mission. Fannie Mae and Freddie Mac's principal business is mortgage securitization. These GSEs buy mortgage loans from the original lenders, pooling and repacking them as mortgage-backed bonds. According to the current edition of Business Week, Fannie and Freddie accounted for approximately 87 percent of mortgage securitizations in December 2007 versus fewer than half in 2005 and 2006.

Over the past 5 years, there have been well-documented financial issues involving Fannie Mae and Freddie Mac. In 2003 for Freddie and in 2004 for Fannie, serious problems were revealed, as we all know, with respect to their internal controls. Through various restatements, it was determined that Freddie had understated its net income by $5 billion while Fannie overstated its earnings by $6.3 billion. Due to these accounting problems, the GSEs have had to restate their earnings for several years and pay fines totaling hundreds of millions of dollars. I hope to learn today from our panelists that these types of financial improprieties are confidently in the rearview mirror.

Over the past two Congresses, I have been an original cosponsor of bills that have helped pave the way for comprehensive GSE reform. S. 1100, introduced by Chuck Hagel and cosponsored by Senators Martinez and Sununu and me, concentrates on focusing Fannie and Freddie's portfolios toward its affordable housing mission, improves SEC disclosure requirements, and requires a comprehensive review of the GSEs' lobbying activities.

Mr. Chairman, it is of the utmost importance that we enact legislation this year to ensure that Fannie Mae and Freddie Mac operate under an effective world-class regulator. As recent events have demonstrated, comprehensive GSE reform is long overdue. One has to look no further than the current proposal embedded in the economic stimulus package for a temporary 1-year expansion of the conforming loan limits from $417,000 to $730,000 to see why the time to act is now. Without such reform, at worse, Congress could end up further jeopardizing the stability of the housing and credit markets, even as this provision is aimed at increasing liquidity and the breadth and depth of the mortgage market. Hence, this Committee has a great opportunity to work in a bipartisan fashion to craft comprehensive reform that I think most of us would agree is long overdue.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Dole.

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman. I want to thank you for holding this hearing and for Senator Shelby working with you in that capacity.

I have a full statement I would like to make a part of the record and ask unanimous consent that it be made a part of the record. In the meantime, I just have a few brief remarks that I would like to make.

For me, and I think for the rest of the Committee, it is sort of a feeling of deja vu all over again. It just seems like it was just a short time ago when we had some huge Government scandals and accounting scandals, 5 years ago, when it came to light in both Freddie Mac and Fannie Mae, and here we are today still debating whether we need adequate regulation or not. In fact, back to that time, I even recall a few issues relating to executive compensation.

So the housing GSEs are huge. Their combined obligations exceed the publicly held debt for the entire United States by more than $1 trillion, and yet we do not have reform. We have seen a dramatic increase in their share of mortgage origination, yet we do not have reform. We have seen a huge increase in their mortgage credit leverage, and still lack reform. We have seen more than $10 billion in financial restatements, and yet we still do not have reform.

Now, despite their promises, Fannie Mae and Freddie Mac are still not timely filers. So I think that it is urgent that we move forward with GSE reform, and particularly in light of the fact that we have, in legislation that has come to the floor of the Senate for a stimulus package, increasing those loan limits where we increase all those factors that have been pointed out to this Committee as a problem.

And so I would hope and urge the Chairman to do whatever he can to get these reforms in an expeditious way.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Casey.

STATEMENT OF SENATOR ROBERT P. CASEY

Senator CASEY. Thank you, Mr. Chairman. I appreciate you calling us together today. I want to thank the panelists who we will be hearing from, both panels.

We have had in the last couple of years, as everyone knows, a real shaking of the confidence of the American people, and I know that since 2003 and 2004, both Fannie and Freddie have come a long way and there have been certainly new management and updating of business practices and all that, and that is wonderful. We appreciate that and we are grateful for that.

But when a public official, when a public agency, or even in the context of Government-sponsored enterprises, whatever we are talking about in terms of public trust, when that is shaken or eroded or in some cases shattered, it takes a long, long time to rebuild that. And I know a lot of people in this town have worked hard to rebuild that trust, and I am confident that is happening. But in some cases, it takes a long time, and that is the kind of trust that we all have to earn as public officials and as participants in public agencies. We have to earn that trust every single day, and even more so if it has been compromised or shattered. So we know that people are working to do that, but it is not going to happen in a couple of years or it is not going to happen overnight.

But I do know that in 2006, Freddie Mac helped 2,098 Pennsylvania families avoid foreclosure while Fannie Mae helped another 2,700. That is good news for our State, and I am sure we could repeat similar numbers in other States. So the GSEs are helping to bring millions of dollars in capital into our cities and our States to help families purchase homes, and I hope we can continue to work together to create a unified, sensible regulatory structure that allows the GSEs to continue bringing the world's capital into local neighborhoods.

But as I said before, we have still a long way to go, and I look forward to working with those who will testify today and with Members of this Committee on that common shared agenda.

Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator Casey, very much.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Mr. Chairman, we have plowed this ground and raked these leaves enough. I agree that we need a strong regulator, and I agree that we are in a crisis, and I look forward to the witnesses.

Chairman DODD. Thank you very much, Senator. I appreciate that.

Well, I thank all of my colleagues. We have had, I think, 13 Members of the Committee here this morning. I appreciate the patience of our witnesses, but you get a sense of the sense of urgency here on a bipartisan basis about the issue and some very common points that have been raised as well. I think without exception everyone has talked about the need for a strong regulator. So we begin, I think, with a good opportunity for us to be able to craft something here. It probably will not be exactly what everyone would like, but like any other product that comes out of a Committee like this, we try to work together to come out with something we can all agree on and move forward.

This is not the only piece of the puzzle, but it is an important piece of doing what needs to be done to restore the sense of confidence and optimism in the country. So, with that, let me thank our witnesses and introduce them quickly, if I can.

Our first witness, David Nason, Assistant Secretary for Financial Institutions at Treasury, serves as the senior adviser to the Secretary, Deputy Secretary, and Under Secretary for Domestic Finance on financial institutions, GSEs, financial literacy, and other issues, and, Mr. Nason, we thank you very much for being with us.

Next will be Jim Lockhart, who has been already referenced here several times this morning, Director of OFHEO. Mr. Lockhart has served as Director since June of 2006 and prior to that served as the Deputy Commissioner of Social Security.

And, finally, we will hear from Ronald Rosenfeld, Chairman of the Federal Housing Finance Board, a position to which he was confirmed by the Senate in December of 2004. Prior to becoming Chairman, Mr. Rosenfeld served as President of Ginnie Mae.

And so I want to welcome all of our witnesses here this morning, and before taking their testimony, I want to note that the witnesses were asked to provide written copies of their testimony 24 hours before the hearing, which is the longstanding tradition of this Committee. I have been on this Committee for 26 years, and we have always required it. It is pretty much a standard requirement before any committee of the U.S. Senate to have the testimony before us. Both OFHEO and the Treasury failed to meet that deadline, I would point out. In fact, Treasury's testimony did not arrive until 6 p.m. last evening, and OFHEO's testimony did not arrive until 4 p.m. yesterday.

We take our oversight responsibilities very, very seriously here, all of us do, and it is critically important that Members and staffs have an opportunity to be able to read that testimony so we can do our jobs here in terms of questioning and raising issues that are important to everyone.

I want to note this is the second time in 2 weeks we have had a problem with the Treasury, Mr. Nason. I want you to carry the message back. I am a new Chairman of this Committee. If that happens again, you will not be appearing before the Committee. Now, there can be extreme circumstances that come up, and certainly let the Committee know when that occurs. But I want testimony here in a timely fashion, and so don't let it ever happen again here, at least under my watch. OK? Do we understand each other on that point? Thank you very much.

Mr. Nason.

STATEMENT OF DAVID G. NASON, ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS, DEPARTMENT OF THE TREASURY

Mr. NASON. Thank you very much, and I will certainly take that message back.

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you very much for inviting me to appear before you today. I very much appreciate the opportunity to present the Treasury Department's perspective on GSE regulatory reform.

The U.S. economy is diverse and resilient, and our long-term fundamentals are healthy. Yet economic growth has slowed, and the risks are clearly to the downside, given current conditions in the housing, credit, and energy markets. Issues related to housing and credit markets bring us directly to the topic of today's hearing. This Committee is very well aware that the housing and mortgage markets are going through a transition period that is exerting stress on homeowners. The current housing downturn comes after years of exceptional housing price appreciation, and the housing market is likely to remain weak well into this year and potentially beyond 2008.

The Administration also recognizes that the GSEs have played an important role in making credit available to current and prospective homeowners. Since year-end 2006, Fannie Mae and Freddie Mac have increased their outstanding mortgage-backed securities by over $600 billion. In addition, outstanding advances of the Federal home loan bank system increased by $184 billion in the third quarter alone.

However, the well-documented accounting and corporate governance problems that emerged first at Freddie Mac in 2003 and then later at Fannie Mae in 2004 raised fundamental questions about the risk management practices at both companies. Substantial progress has been made to address these issues, but challenges remain. In addition, the Federal home loan banks were not immune to similar risk management issues as the regulatory actions associated with problems at the Federal Home Loan Bank of Chicago and the Federal Home Loan Bank of Seattle illustrated.

More recently, much like other financial institutions involved in mortgage finance, Fannie Mae and Freddie Mac have experienced various levels of stress in the current mortgage environment. For example, in the third quarter of 2007, Fannie Mae and Freddie Mac reported losses of $1.5 billion and $2.1 billion, respectively. All of these factors point to a clear and urgent need for completing housing GSE regulatory reform, and we thank this Committee for taking this important step toward this goal.

The Treasury Department's core objectives for housing GSE regulatory reform are: first, the need for a sound and resilient financial system; and, second, increased homeownership opportunities for less advantaged Americans. It is paramount that the housing GSEs properly manage and supervise the risks they undertake and that a strong regulator oversee their operations. Otherwise, their solvency could be threatened, and this could have a negative impact on the stability of other financial systems and the overall strength of the economy.

Throughout the debate on housing GSE regulatory reform, the Treasury Department's focus has been on ensuring that the new regulator has all the powers, authority, and stature required to perform its mandated function. In this regard, the new regulator's powers should be comparable in scope and force to those of our Nation's other financial regulators.

Many of the following key elements of housing GSE regulatory reform have been debated in recent years: providing authority to set capital, providing receivership authority, transferring new activity approval and mission oversight from HUD, providing independent funding and litigating authority, eliminating Government-appointed directors to the GSEs' boards, and combining the regulatory authority over Fannie Mae, Freddie Mac, and the Federal home loan banks.

The housing GSE regulatory reform bill passed by the House of Representatives addresses many of these issues aforementioned in an adequate manner. However, additional elements of reform are necessary to address the GSEs' particular characteristics.

In addition to addressing the fundamental shortcomings in the current GSE regulatory structure, it is just as important that the new regulator have the appropriate authority to consider the unique characteristics of the GSEs and their housing missions. The housing GSEs were created to accomplish a mission, and they were provided a certain set of statutory benefits to help in carrying on that mission. Freddie Mac and Fannie Mae operate in the secondary mortgage market by providing credit guarantees on MBS or by directly investing in mortgages and mortgage-related securities through their retained mortgage portfolios.

The combination of three key features of Fannie Mae and Freddie Mac's retained mortgage portfolios warrant the attention of policymakers: first, the size of the retained mortgage portfolios of Fannie Mae and Freddie Mac, $1.4 trillion as of year-end 2007; two, the lack of effectiveness market discipline over these organizations; and, three, the interconnectivity between the GSEs' mortgage investment activities and the other key players in our Nation's financial system, both insured depository institutions and derivatives counterparties. The combination of these three factors caused the GSEs to present the potential for systemic risk to our financial system and the global economy.

Policymakers have been struggling with the inherent tension and the potential problems posed by the GSEs for years. In fact, a Treasury Department official stated in testimony a few years ago, and I quote, "[a]s the GSEs continue to grow and to play an increasingly central role in the capital markets, issues of potential systemic risk and market competition become more relevant."

That statement was not from a member of the Bush Administration Treasury Department but, rather, from testimony delivered in March of 2000 by then-Under Secretary Gensler of the Clinton Administration Treasury Department.

As we further consider authorities of the new GSE regulator to address the long-run issues posed by their retained mortgage portfolios, the new housing GSE regulatory agency must be provided specific review authority over the retained mortgage portfolios. Such authority must establish a clear and transparent process based on guidance from Congress on how the new regulatory agency will evaluate the retained mortgage portfolios in terms of risk and consistency with mission.

In conclusion, we at Treasury remain convinced that a new regulatory structure for the housing GSEs is essential if these entities are to continue to perform their public mission successfully. We look forward to continuing to work with you on this important issue.

Thank you very much.

Chairman DODD. Thank you very much, Mr. Nason. That was good timing, too. Right on the button here.

Mr. Lockhart.

STATEMENT OF JAMES B. LOCKHART III, DIRECTOR, OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Mr. LOCKHART. Mr. Chairman, Ranking Member Shelby, Members of the Committee, thank you for the opportunity to testify on the critical need for GSE regulatory reform.

The GSEs have become the dominant mortgage funder in these troubling times as they fulfill their missions of providing liquidity and stability and affordability. They have been reducing risk in the market, but concentrating mortgage risk on themselves. They are now being asked to take on even more risk in the subprime and jumbo markets. Given the past accounting and operational problems of both Fannie Mae and Freddie Mac, OFHEO directed the enterprises to take many remedial actions. We also capped the growth of their portfolios, which we loosened last September, and required them to keep capital levels 30 percent higher than the minimum required by law. In retrospect, these actions were extremely important in reducing credit losses and preventing disruptions of the conforming loan market.

Both enterprises have made significant progress on their remediation efforts, but significant issues do remain. They did publish third quarter financials, but that accomplishment was dampened by about $3.5 billion of losses. They expect to produce timely 2007 financials at the end of this month.

During 2007, the housing GSEs' debt and guaranteed MBS outstanding grew 16 percent to $6.3 trillion. To put trillions in perspective, this chart you have a copy of, a simple comparison is to the debt of the United States, which was $5.1 trillion, including that held by the Fed. The whole debt of Fannie and Freddie in their MBSs equals that, and if you add on the Federal Home Loan Bank's debt of $1.2 trillion, you get $6.3 trillion of debt.

Housing market conditions in many parts of the country are weak. Virtually all measures of the housing market have deteriorated very sharply, especially over the last two quarters. During this period of turmoil, the enterprises have provided stability and liquidity to the conforming mortgage market. They have securitized almost $100 billion a month in mortgages. As a result, there has been a dramatic reversal in their market share, as you can see in this next chart.

Their share of total mortgage originations was less than 38 percent in 2006. By the fourth quarter of this year, it had doubled to 76 percent. They are effectively, combined with the Federal Home Loan Banks, the mortgage market. Actually, it might be 90 percent if you added in the Federal Home Loan Banks.

Credit losses and risks are growing. In the fourth quarter, they cut their dividends and raised almost $14 billion in preferred stock, which is critical, as both CEOs have said they are going to have very tough fourth quarters and 2008s. An increase in the conforming loan limit will add to the enterprises' risk. OFHEO believes an increase should be coupled with quick enactment of comprehensive GSE reform.

Jumbo loans would present new risks to the already challenged GSEs. Underwriting them successfully will require new models, systems, and tough capital allocation decisions. OFHEO has promised to work closely with Fannie Mae and Freddie Mac to ensure that an increase is implemented as quickly, safely, and soundly as possible.

Why is GSE reform so critical now? As I said, they have really become the secondary mortgage market in these very troubling times, and they need to continue to provide that liquidity. We in turn need to maintain confidence in the GSEs, especially with foreign and domestic investors, who hold that $6.3 trillion of securities.

We need to rebuild confidence in the housing and mortgage markets. Their growing credit losses, risk, and market share requires a stronger regulatory framework to reduce the potential risk to the financial markets.

The first component of comprehensive GSE reform is the creation of a single, unified, and independent GSE regulator by combining OFHEO, the Federal Housing Finance Board, and HUD's mission and product authority.

Second, as the enterprises agree, the regulator needs bank regulator-like powers, including receivership and independent litigation and budget authorities. Most critically, OFHEO needs the flexibility to adjust capital requirements, both the statutory minimum and the risk-based requirement, which is not even working at the moment.

Finally, the new regulator needs to be able to consider mission fulfillment and risk of the portfolios.

I believe the House bill is a good start, but the effective date should be upon enactment. The GSEs are stretched and are being asked to do more. I note the Committee's strong agreement that we need to restore confidence by creating a much stronger, unified regulator to support the U.S. housing finance system. I look forward to working with you to achieve GSE reform soon.

Thank you.

Chairman DODD. Thank you very much, Mr. Lockhart.

Mr. Rosenfeld, thank you very much.

STATEMENT OF RONALD A. ROSENFELD, CHAIRMAN, FEDERAL HOUSING FINANCE BOARD

Mr. ROSENFELD. Thank you, Chairman Dodd, Ranking Member Shelby, and distinguished Members of the Committee. Thank you for the opportunity to present a statement to you about the importance of reform of Government-sponsored enterprises. The views that I will be expressing today are mine and do not necessarily represent the views of my colleagues on the Federal Housing Finance Board.

The Congress and the administration have discussed and debated reform of the GSEs for years. I believe it is now time to act. Together, the Federal home loan banks, Fannie Mae, and Freddie Mac play a vital role in helping to finance homeownership for millions of Americans, and stabilizing and strengthening housing and financial markets and the economy at large.

Given the size and significance of these institutions, which together have more than $3 trillion in assets, it is imperative that they be supervised and regulated by a single Federal regulator and that the regulator have all the tools necessary to provide effective and thorough oversight.

The Federal banking agencies have a full arsenal of supervisory and enforcement tools at their disposal which allows them to take early and resolute action, if necessary. Those tools include examination, capital, and enforcement authority over the institutions they regulate. A new GSE regulator should, at a minimum, have the same tools possessed by the Federal banking agencies.

In particular, a new GSE regulator should have the ability to fund itself through the assessment of the GSEs and be outside of the appropriations process. It should have the ability to place a GSE into receivership or conservatorship. It should have the authority to approve new and existing business activities. And it should have the power to set minimum capital levels.

The Finance Board already has the authority to assess Federal home loan banks to fund its operations. Among the Federal financial institution supervisory agencies, only OFHEO relies on appropriated funds. In addition, the Finance Board has the authority, and exercises it, to require an individual Federal home loan bank to have and maintain additional capital, to approve new business activities, and to regulate the composition of the Federal home loan bank's assets portfolio.

A single, unified GSE regulator would provide for a more efficient and effective regulatory body. It would be more efficient in its ability to share examination and supervisory information among examiners and other agency staff. The agency's risk modeling would be enhanced by greater interaction and consultation among the quantitative risk professionals already in place at OFHEO and the Finance Board. Examination and risk management expertise and resources could be shared as appropriate, particularly in dealing with complex or significant supervisory matters at one of the enterprises or the home loan banks.

Finally, all GSEs should have to meet the same high governance and disclosure standards. At present, all 12 Federal home loan banks are registered with the SEC and are subject to its oversight of their financial statements and disclosure.

While I believe consultation and interaction are critical attributes of a single Federal regulator for the housing-related GSEs, the differences between the Federal home loan banks and the enterprises must also be recognized and accommodated through any legislation that would reform GSEs' supervision. The Federal home loan banks are member-owned cooperatives. Their corporate structure and their business operations are far different from that of shareholder-owned Fannie Mae and Freddie Mac. These differences exhibit themselves in different capital structures, different board structures, and different orientations toward return to shareholders and the pricing of products to their customers.

Also, the essence of the Federal home loan banks' business is secured lending, where most of the collateral is mortgage loans. The Federal home loan banks do not securitize mortgages, and the direct mortgage holdings are only 7.2 percent of their assets.

In conclusion, the recent stress in the housing markets has taught us that the GSEs are vital to supporting the Nation's housing needs. In particular, Federal home loan bank advances have provided critical liquidity to members whose alternative sources of funding have dried up. A single regulator would assure homebuyers and the market participants that the overseer of the housing GSEs speaks with a single voice, acts with a consistent purpose, and is clear, consistent, and vigilant. While the housing GSEs can and do operate in a variety of different ways to fulfill their housing finance mission, they have a common heritage, they share many of the same customers, they raise funds from the same sources; and the recent environment has shown us that whether they securitize mortgages, whether they own mortgages, or whether they take them as collateral, they have common concerns.

Simply put, the reform of GSEs makes sense. It will help promote a healthy and vibrant housing market.

Thank you.

Chairman DODD. Thank you very much, to all three of you here, and what I would like to do is try and keep our time to—with this many Members here, let's say 6 minutes here for questions and answers in the first round, and then we can give a chance to everyone to stay involved and make as many Members be able to stay as possible. I know if we move a little quickly here, we can maintain that participation.

I mentioned, Mr. Lockhart, at the outset of my remarks the statement that you make in your prepared statement for this morning, and just to read it here, it said, "The GSEs have become the dominant funding mechanism for the entire mortgage system in these troubling times. They are fulfilling their missions of providing liquidity, stability, and affordability to the mortgage markets." You go on to say, "In doing so, they have been reducing risk in the market, but concentrating mortgage risk on themselves." And you go on. But I appreciate that statement in that paragraph. It is an important one.

Let me ask you, if I can, to take a look at the proposal—Senator Schumer raised this issue, but I raised it more directly here, and that, again, I am pleased to note in your testimony on page 11 that you have "encouraged the enterprises to increase subprime rescue mortgages," to quote you. And in my view, and I think the view of some here, Fannie and Freddie could play a very constructive role in this regard as well, given the importance of it.

Could the current capital surcharge to be devoted to this purpose, at least in part? For example, could Fannie and Freddie use their capital to buy subprime loans and restructure them to help keep homeowners in place? In his testimony, Dan Mudd notes that Fannie Mae is very close to fulfilling all the requirements of the 2006 consent order which he signed with OFHEO. You have made reference as well that there are still some outstanding issues you just pointed out. And what is the appropriate response of the regulator at that point with regard to the capital surcharge and the portfolio limits?

Mr. LOCKHART. We have been looking at that 30 percent capital surcharge. We have been talking to the two companies about it. It was imposed because of their operational problems. They made good progress, but they still have a series of issues to go on the operational side and, obviously, they have significantly more credit risk than when it was imposed a long time ago.

Chairman DODD. Right.

Mr. LOCKHART. We are working with the two companies. We are developing lists of what has to be done to get that 30 percent removed. You are right. We have been encouraging them to do more in the subprime area, and they have done a lot of refinancings of people out of subprime into more prime-like, less risky mortgages. They have been making good progress on that and will continue to do that.

They do have enough capital at the moment to do more, especially in the securitization area. Securitization takes about 20 percent of the capital versus having to buy them and put them in their portfolios. They have been doing more. They are taking these rescued mortgages and putting them into their mortgage-backed securities and are selling them. We are continuing to monitor that and working with them.

Chairman DODD. What about the amount that is in there? There is about $17 or $18 billion, I think. There is 8 or 9—I forget the numbers exactly there that exist. What would be your recommendation regarding that?

Mr. LOCKHART. Are you talking about the capital at this point?

Chairman DODD. Yes.

Mr. LOCKHART. My recommendation is that we need to be very careful as we take this off, given the added risks that these two companies have. We need to be very careful.

I think the important thing is I would be much more comfortable taking this off if I had regulatory power to look at capital. At the moment I really do not. These were only imposed because of a consent agreement. What we need—and it is a key part of the legislation, as many Members have mentioned—is to give the regulator power to look at minimum and risk-based capital.

Chairman DODD. Well, I appreciate you getting back on message here. That is important here. Let me try the question again. What do you think about the possibility of utilizing that capital?

Mr. LOCKHART. As I said, we are working with the two companies' management teams to start to free up that capital, and we will as we see progress on these operational issues.

Chairman DODD. OK. Mr. Nason, let me ask you, if I can, Secretary Steel was here last week, as you know, talking about the Hope Now Alliance, and I mentioned at that time that it was about a year we met in this very room with stakeholders to try and encourage workouts with the people, owner-occupied homes that would fall into delinquency or, worse, into foreclosure. I think he heard considerable concern from Members up here regarding the responsiveness of the industry for the need for quick action. And we heard from some housing counselors working with borrowers, from servicers and other advocates, that the GSEs' policies are making it more difficult to get loan modifications done prior or immediately after a delinquency. As you know, getting borrowers early is very important. It obviously makes some sense.

I wonder if it is your view or the view of the Department here that the GSEs are being as helpful—or not helpful—as possible in the effort to get these loan modifications worked out.

Mr. NASON. Thank you for that question. I think it is safe to say that the GSEs are trying to be helpful. Both the GSEs are members of the Hope Now Alliance, and they have been supportive of our efforts. So I think it would be a safe assumption to say that they have been a force for good in trying to work on the situation, although the comments that Senator Schumer made earlier about whether or not the GSEs could be helpful in helping lenders write down loans faster, that is something that is certainly worth exploring.

One of the things that is holding up a significant amount of modifications and refinancing from occurring is whether or not lenders are willing to take the fair value on these loans, and whether or not the GSEs could provide some leadership in that area is something definitely worth exploring.

Chairman DODD. Let me ask you, Mr. Rosenfeld, the American Banker reported on Tuesday that the Board of Directors of the Federal Home Loan Bank of Dallas and Chicago voted to approve a merger of the two banks. As I understand it, there has never been a voluntary merger. You can correct me, historically, if I am wrong about this, but our information is that there has never been a voluntary merger in the home loan bank system. And the last merger, which was not undertaken voluntarily, was done some 60 years ago.

This proposed merger raises some very serious questions, and the statute under which you operate does not specifically address voluntary mergers. But you may correct me on that. There may be someplace here you will tell me otherwise.

I wonder what standards are going to be used to decide whether or not to approve the merger. And do you expect to follow an open process, allowing for comment by the other banks and their members, who are, after all, jointly and severally liable under the statutes here for the debt issued by the Dallas and Chicago banks?

Mr. ROSENFELD. Senator Dodd, the Chicago bank and the Dallas bank have been engaged in merger conversation. Our responsibility will be to review the safety and soundness of whatever may be ultimately proposed. An application for merger has not come forth to us, so at this time we have not addressed that issue.

The single most significant element in our deliberations will be the safety and soundness of the banks and, of course, the overall system. I think it is public knowledge that the Chicago bank is currently operating under a consent cease and desist order which prevents it from stock redemptions and dividends and so on. So suffice it to say, that institution has a somewhat long history of having some distress in its operations. The Dallas bank has been very well run, number-one-rated bank, and we have very high regard for that institution.

As I have said on other occasions, although there are 12 home loan banks, there is no particular reason there has to be 12 home loan banks. If two banks for their own reasons decide they want to combine and it meets our standards of safety and soundness, I think that is the ultimate test.

In terms of the process, we have not determined the process that we will utilize because, quite frankly, that issue is not ripe at this time, although I will tell you that I think it is fundamentally a matter between the two banks involved. I think that without question, if it were to occur, a very important element would be the judgment that it enhances the safety and soundness of all the—of the two banks and, of course, the entire system. So that would be——

Chairman DODD. Well, I appreciate that. As I point out, there is a joint—and I am going to move on because I have gone over my time already, but the joint and several liability issue raises some additional questions. I appreciate your point. And also, just to be—and I would ask you to do it in writing, the statutory background that would—I was just unclear since there have not been any historically. Is there something that we ought to be concerned about here in terms of the authority of the board to make that decision?

Mr. ROSENFELD. There has never been a voluntary merger.

Chairman DODD. Right.

Mr. ROSENFELD. There was an event in 1946 where the bank moved, and two banks actually got together and then moved. That was involuntary. It resulted in some lawsuits, and ultimately the move was sustained.

We believe, based upon the advice of our counsel, that we do have the authority to merger two banks if that were deemed appropriate, if it were requested and deemed appropriate.

Chairman DODD. OK. Thank you.

Senator Shelby.

Senator SHELBY. Some of the basic principles for GSE regulatory reform—and I will start with you, Mr. Lockhart. In your opinion, what are the most important components in any reform measure that we undertake here?

Mr. LOCKHART. There are several important components. A key one will be to combine the three GSE regulators into one entity to give it the power and the prominence and the breadth that it needs. Critical also will be the capital one I just discussed with the Chairman and the portfolio, to make sure that they are focused on mission and the risk of those portfolios.

Senator SHELBY. Talk just for a minute about the systemic risk that Chairman Greenspan, Chairman Bernanke, and others have spoken of, the systemic risk of the GSEs to the whole financial system, to the taxpayers, considering the thin capital that they have.

Mr. LOCKHART. I believe systemic risk is an issue of any safety and soundness regulator, and these two in particular. As you can see in that market share chart we had up earlier, they have become the system for secondary mortgages in this country. If either one of them had any serious troubles, it would really have a major impact on the mortgage markets in this country and potentially the financial markets.

We have to be very careful as we add more risks to them that we also give the regulator much stronger powers.

Senator SHELBY. And product approval?

Mr. LOCKHART. Product approval is also an important issue, and the whole bank-like regulatory powers are needed too.

Senator SHELBY. Are very important. Do you agree with that, Secretary Nason?

Mr. NASON. I do. I agree with Director Lockhart on that.

Senator SHELBY. Mr. Rosenfeld.

Mr. ROSENFELD. Yes, sir.

Senator SHELBY. Secretary Nason, in negotiating a stimulus package, the administration—you are part of it—indicated its intent to target the package to those with the greatest financial need. The administration also previously indicated to a lot of us—Secretary Paulson very explicit about it—indicated that the GSE loan limit would not be increased absent comprehensive reform. Now we are looking at a package that includes the increase without reform.

Given that the only people who could qualify for those high-end mortgages have incomes well over $100,000 a year, how does this square with the administration's stated goal for fiscal stimulus? And why is it important that we help the jumbo portion of the home mortgage market when the current $417,000 limit is already

2.3 times the national median home price for the U.S. of $223,800? Was that a political decision? Sure it was. You cannot say, but——

Mr. NASON. As you know, Senator, this was a package negotiated by my boss, Secretary Paulson, and——

Senator SHELBY. After he told us he was not going to do this in conference. He met with Republicans. I asked him the question, was he and the administration soft, going soft on GSE reform, and he said, "Absolutely not." I asked him the further question, was he going to negotiate the limits, upper limits. He said, "Absolutely not." Two hours later, he did it. I have not met him lately, but we will see each other again. [Laughter.]

Mr. NASON. I am sure you will, Senator Shelby. I guess what I would say is two things.

First, in no way does this being part of the stimulus package undercut the Secretary's commitment to comprehensive GSE reform.

And, two, I think the Secretary was quite——

Senator SHELBY. It does not undercut it? Now, how do you square that? I want you to explain that.

Mr. NASON. Well, I think the importance of us being here right now is suggesting how important it is for us to have GSE reform, and the Treasury Secretary is committed to that.

And then, second, I would just like to say——

Senator SHELBY. But how committed is he?

Mr. NASON. Well, he said right after the—or at the discussions on the stimulus package that this is not something that he was strongly advocating.

Senator SHELBY. Well, I know Mr. Lockhart is committed to it, and I know Mr. Rosenfeld is. But I am not sure about Secretary Paulson. You know, he says one thing and does another.

Mr. NASON. The Secretary is committed to comprehensive GSE reform, sir.

Senator SHELBY. I have not seen it yet. I hope you are right, but I doubt it.

How will you, Mr. Lockhart, as the safety and soundness regulator, ensure that these additional risks are well managed by the GSEs? In other words, as we run the loan limit up, how are you going to manage that? Because there is a lot more risk there. If Fannie Mae and Freddie Mac, for example, had been more active over the past 2 years, had had the jumbo loans, in States like California and others, which have the largest price declines in recent months, what do you believe would have been the impact on the financial condition of Freddie Mac and Fannie Mae if their loans that they bought went down in the price—the houses?

Mr. LOCKHART. Certainly, many of the jumbo loans were done on a relatively risky basis. People were reaching to get into houses. There was a lot of floating rate, adjustable rate mortgages, interest only, and negative amortization done. Very few, actually, 30-year fixed were in the jumbo market. Probably only 50 percent. They were, yes, much riskier. They had credit risk. They had significantly more prepayment risk. And it could have had a serious impact.

Overall, as you will hear from the two CEOs, the books that they took on in late 2005, 2006, and early 2007 were much riskier even in the conforming area. It could have had a serious impact.

We are going to work very closely with the two management teams as they look at this. There are significantly more risks that they are taking on, and they need new risk management systems, new pricing models, and internal controls. They have new product processes in place. We will watch them and work with them to do this.

But this is complex. By using the FHA standards, there could be hundreds of different mortgage limits around the country, much more than there were in the original House bill. It is also going to cover a lot more people than the original House bill in that it could cover people——

Senator SHELBY. More people, more risk?

Mr. LOCKHART. More people, more risk. It could go down to an area with a median house price of $335,000, so well below the conforming, and bring it above the conforming. And as you said, it could also go up to $730,000.

Senator SHELBY. Mr. Rosenfeld, tell us again how important is it that we include in any reform of the GSEs the Federal home loan bank system? Why is it important to tie that into it?

Mr. ROSENFELD. Senator, I believe it is important for a number of reasons beyond what I mentioned in terms of working together and having greater expertise. I think one of the reasons that it is very important is the history of the Federal Home Loan Bank Board. I believe that I was the ninth Chairman in 14 years. That suggests something of a lack of stability in that structure.

Some years ago, the American Banker was frequently reporting on food fights at board meetings. We do not have that today. Actually, today, Senator, we are having, I think, an excellent working relationship between the colleagues on the Board. I can tell you personally I like my colleagues and I respect them. I think we are working very hard addressing the problems we have to deal with today. But this is a relatively unique period in the history of the Federal Home Loan Bank Board, and I would suggest that there are some problems with its basic structure. You have basically five—you have five directors, four of whom sit probably within 50 feet of each other, each having an assistant and an administrative assistant. And we regulate 12 banks. It gets a little bit awkward.

I think another——

Senator SHELBY. Are 12 banks too many?

Mr. ROSENFELD. Pardon?

Senator SHELBY. The 12 banks, is that too many?

Mr. ROSENFELD. No.

Senator SHELBY. Not necessarily?

Mr. ROSENFELD. Oh, maybe we could do with less, but if they are cooperative—they are owned by the members. If they choose to have 12, there will be 12. We have no intentions of creating any mandatory rule that there be less than 12. If banks decide to get together, we would, you know, look at it at that time.

Senator SHELBY. Or if some of them get real shaky?

Mr. ROSENFELD. Then they may find themselves closer together.

Senator SHELBY. And do you have the power to do that?

Mr. ROSENFELD. We believe we do. And one other thing which has just come up, which I think is incredibly important. Given the serious chaos in the mortgage finance world, it became very apparent to me that if any of the major players in the industry, the major banks, mortgage companies, were to have a serious, serious problem, Fannie and Freddie and the home loan banks would find ourselves having a very common concern in terms of what the hell do we do with the situation now. And it, I think, would be a much stronger source of protection for all of us if, in fact, we had one regulator to deal with what is fundamentally the same business that we are both in, which is the mortgage business.

Senator SHELBY. But you do not need a regulator unless the regulator has power, do you?

Mr. ROSENFELD. Well, absolutely. And I think another factor that you got me to think about is the fact that if you are going to attract really top people to a world-class organization, they have to have an organization that is structurally world class. And I think that would be an extraordinarily significant step in getting the kind of folks or people to run this combined regulator.

Senator SHELBY. And a regulator that is above politics, if you can find such a person in Washington, D.C., right?

Mr. ROSENFELD. I think that you can, Senator.

Senator SHELBY. As much as you can.

Mr. ROSENFELD. I think you can find some very fine people, but you have to give them the opportunity to really do their job without the interference that may come from an appropriation process or such things.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman DODD. Above politics?

Senator SHELBY. Yes.

Chairman DODD. Senator Carper.

Senator CARPER. Thanks, Mr. Chairman. Gentlemen, welcome. It is good to see all of you. Thank you for being here today and for your testimony.

I think what I would like to do is just start off by going through the things I think you agree on, all right? And one of those is, as I have listened to your testimony, I believe I heard you essentially say that you agree that the House-passed bill is a real good starting point for us in the Senate. Is that pretty much how you feel?

Mr. LOCKHART. Yes, Senator.

Senator CARPER. Thank you. I believe that each of you have said that you feel that we do not need two regulators, we need one regulator, both for Fannie Mae and Freddie Mac and for the Federal home loan banks. Do you agree on that?

Mr. NASON. I do.

Mr. LOCKHART. Yes.

Senator CARPER. OK. We have heard you say that you believe the regulator should be independent and independently and not have to depend on annual appropriations. Is that correct?

Mr. NASON. Yes.

Mr. LOCKHART. That is correct.

Senator CARPER. All right. I believe we have heard you say that the regulator ought to be able to set minimum risk-based capital requirements, not have those statutorily but have that——

Mr. NASON. Yes.

Mr. LOCKHART. Yes.

Senator CARPER. OK. And that the regulator should have enhanced enforcement authority, I think you said that.

Mr. LOCKHART. Yes.

Mr. NASON. Yes.

Senator CARPER. Talk to us about SEC registration. I think Fannie is on track. I believe all the 12 Federal home loan banks have been registered. But just give us your thoughts on that. It is not clear to me.

Mr. LOCKHART. You would like me to?

Senator CARPER. All three.

Mr. LOCKHART. OK. I could start out.

Mr. NASON. Sure.

Mr. LOCKHART. We believe SEC registration is critical. All 12 Federal Home Loan Banks are. Fannie is registered and they are hopefully going to become timely when they file at the end of this month, and hopefully they also will become Sarbanes-Oxley compliant at that point.

Freddie Mac, on the other hand, has never been registered with the SEC. It is starting the process. And after it files its statements in February, it will start the process, and hopefully by the middle of this year it will be SEC registered and by the beginning of next year, Sarbanes-Oxley compliant.

Senator CARPER. All right.

Mr. NASON. I would share that view. I would say that making them file like any other private company is an indication that they are not a different type of corporation, and more disclosure to investors that are investing in their debt and stock is always a positive thing from our perspective. So we would be supportive of that.

Senator CARPER. OK. I believe we have heard you say that, unlike the situation now where you have—the regulator has authority over financial operations and so forth, but HUD has responsibility and oversight over the program, that we should consolidate those two into a single entity. We are in agreement on that, are we not?

Mr. NASON. Yes.

Mr. LOCKHART. That is very important to me. All the other regulators have that. By fragmenting the new product authority from safety and soundness and mission, you can lead to a lot of tensions that do not make a lot of sense.

Senator CARPER. OK. There is another—Senator Martinez—from time to time I ask him to put on his old HUD hat as HUD Secretary, and we talk about a path forward on GSE reform. And one of the things that he and I have talked about in the last week or so is this—this is really the issue that Senator Shelby has raised, and that is, whether we should include in the stimulus package—which I think we are going to be voting on later today. Should we include in the stimulus package a limit on—a portfolio loan limit up to about $730,000 for Fannie and Freddie? And in the legislation that we are contemplating, it would provide for a 1-year extension or a 1-year grant of that authority. That would take us to either the end of the year or the early part of next year.

My fear—I believe in the old adage that work expands to fill the amount of time we allocate to do a particular job. And we have a way around here, if we get into early October and we have not done it, there is a pretty good chance we are not going to do it this year. And we will kick it off into a new administration, into next year and a new Congress, and then hopefully not start all over but we could, and then just delay it further.

Senator Martinez and I have talked about maybe we are going to include a provision in the stimulus package to allow this increase in the conforming loan limit, that we make it for 6 months rather than for 12. Would you have any thoughts along those lines?

Mr. LOCKHART. As you all know, I believe strongly that if you are going to increase the conforming loan limit, it is critical to give the regulator more powers. And that is why hopefully we can do this legislation very quickly. One incentive might be to shorten the time of the increase. It may take several months for the two entities to install the kind of systems and have the right kind of culture and risk management around these products. So it may take 2 or 3 months to get there to begin with. The key thing is that we need to get GSE reform so that by the time they are in place and ready to start doing these jumbo loans, we actually have a stronger regulator. And that is what I humbly ask every Member of this Committee to work on.

Senator CARPER. Any other thoughts on this?

Mr. NASON. I would echo the Director's comments about the need for GSE reform, but the Administration supports the current stimulus legislation.

Senator CARPER. Thank you. A question for Mr. Lockhart, if I could. We have talked about the affordable housing fund, something that Senator Reed has championed, and certainly I strongly support. It has been a point of some contention in the past, as you know.

If the affordable housing fund that is included in the House bill were enacted today, any idea what would be, just roughly, the annual contributions from Fannie or Freddie maybe this year or next year, maybe even the year after that?

Mr. LOCKHART. The annual contributions as done in the House bill are a percent of their whole book of business. I believe it is 1.4 basis points. It is about half a billion and growing.

Now, obviously, with the companies both losing money, there are some issues around that, but that is what the numbers are at the moment.

Senator CARPER. But given where the companies are financially now, what would you estimate the housing fund contributions would be for maybe this year and at least——

Mr. LOCKHART. Because it is on the whole book of business, it would be that half a billion dollars. The only issue we would have to think about is how to put that in place given that they are already losing a significant amount of money.

Senator CARPER. All right. Thanks very much.

Thanks, Mr. Chairman.

Chairman DODD. Senator Hagel.

Senator HAGEL. Thank you, Mr. Chairman.

Director Lockhart, I noticed in Mr. Mudd's testimony, which we have received—and the Chairman noted part of this in his beginning questions to you—that in that testimony, and I will quote, Mr. Mudd says, "Only one hurdle remains for us to fully comply with the 81 recommendation measures called for in our 2006 consent order with OFHEO. That hurdle is the filing of our fully audited 2007 results with the SEC, which we will have done at the end of the month."

Is that accurate?

Mr. LOCKHART. Well, there are a handful of ones that we are still looking at, so we have not signed off on. In addition, about 45 of the 81 included plans, and so we have to look that they are implementing those plans. They have presented the plans, but we want to make sure that they are implementing them. Just putting out a plan, does not help unless you are implementing it. We are reviewing that as well.

There are issues that we need to continue to work on like operational risk capital, and economic capital. There are a whole series of issues that need to continue to be worked on.

Senator HAGEL. So would it be a fair assessment that Mr. Mudd took some liberty with that statement?

Mr. LOCKHART. I believe it is technically correct, but I especially if you are talking, as the Chairman was, about removing the 30 percent capital, there are significant other issues that still have to be addressed before we get to that. I am hopeful that they can get it done quickly, and we are working with them on that list of what needs to be done.

Senator HAGEL. And how many issues would you say out of the 81 that they are still working on?

Mr. LOCKHART. I do not know. I cannot give you a number. But it is probably in the single digits.

Senator HAGEL. What specifically can you tell us regarding internal control and risk management recommendations?

Mr. LOCKHART. Certainly they have some ongoing internal control issues in both companies. They have done a lot. As I said, Fannie will be Sarbanes-Oxley compliant. But that requires a lot of manual activities and they need to get more systematic about them. Freddie is not Sarbanes-Oxley compliant and, again, they need to work a lot on their internal controls.

On the risk management side, we all agree that they need to adopt a new economic capital framework, and that is part of the legislation. We are all working together on that, but that is going to take a while. I think that is critical going forward that we make sure that their capital grows when the risks grow. And that is going to take some significant work.

Senator HAGEL. For both Fannie and Freddie.

Mr. LOCKHART. For both Fannie and Freddie, yes, Senator.

Senator HAGEL. Thank you. You responded to some questions from Senator Carper regarding the SEC and registration with the SEC. And I want to quote from a letter I received recently from Chairman Cox and then ask a question. And I had inquired with the SEC Chairman on some of these matters, and he responded as part of that letter, "I firmly believe that because GSEs sell securities to the public, have public investors, and do not have the full faith and credit of government backing of government securities, GSE disclosure should comply with the disclosure requirements of the Federal securities law." And, of course, you agree with that, and I assume your colleagues at the table agree with that.

Here is the question: In your opinion, should Fannie and Freddie be required to register their debt and mortgage-backed securities as well as their common stock with the SEC?

Mr. LOCKHART. That is a good question. I agree wholeheartedly with the Chairman that they need to adopt full disclosure, and probably even more disclosure, given the significance of their size and their importance to the American economy.

Registering their debt has some pluses and minuses. It will raise the cost of debt somewhat. If they have a full registration with the SEC for their common stock, that is probably enough in most circumstances.

Senator HAGEL. So would you see value or not value in registering——

Mr. LOCKHART. There would be some value, but not significant value added there. I would think there are other places to put their resources at this point.

Senator HAGEL. Well, let me ask it this way: In light of the question that has been presented and the environment of the market today, confidence, as we know, drives markets.

Mr. LOCKHART. Right.

Senator HAGEL. Would this enhance confidence, do you believe, or not?

Mr. LOCKHART. On the margin, it probably would enhance confidence somewhat, yes.

Senator HAGEL. Mr. Nason, would Treasury have a position on this?

Mr. NASON. Yes, I would agree with that. More information about the companies disclosed to the public would be beneficial at the margin. I think a full equity registration statement would provide a significant amount of information about how they operate, but at the margin, I think it would be helpful.

Senator HAGEL. Well, also, all of the other institutions, companies in the marketplace are required, are they not, to make those disclosures with the SEC?

Mr. NASON. Yes.

Senator HAGEL. Why then would we exempt the GSE?

Mr. NASON. That was what I was trying to say earlier to Senator Carper's question, which is exempting them from the registration requirements just conveys more special status on them, and that is something that we would not be supportive of. So additional registration would be fine. I was just trying to say how much additional information you would get from the debt registration requirements.

Senator HAGEL. Would you like to add anything to that, Director Lockhart?

Mr. LOCKHART. No. That is right. More disclosure is better. I think one of the issues is that they are very large debt issuers and a lot of their debt looks very similar. So the process of more of a shelf-type structure would make sense.

Senator HAGEL. Thank you.

Mr. Chairman, thank you.

Chairman DODD. Thank you very much, Senator.

Senator Reed.

Senator REED. Thank you, Mr. Chairman.

Mr. Lockhart, I was very much interested in your chart depicting how Fannie, Freddie, and the home loan banks have stepped into the breach, and I agree with your conclusion it shows the critical role they are playing. But isn't this a rapidly contracting market? And might some of this 71 percent be a function not so much of super activity as the fact that everybody else has left and the market is getting much smaller?

Mr. LOCKHART. It is a combination. The market is not growing as much as it has in previous years, obviously, but their growth has been dramatic. In fact, probably more than in any previous year. So, yes, they are growing a lot. The market is not growing as much as it had historically done. So, it is a combination. But the point is that all that risk is coming on them where it used to be spread through many other mechanisms.

Senator REED. But I think one of our challenges, frankly, stepping aside from simply the regulatory issues, is to expand that market once again at a dramatic rate. You know, one of the reasons why they are taking up all this risk is that—and we have been through this debate about capping their participation because the private sector really should be able to get in there and get the job done. A lot of these private actors turned out to be predatory lenders in the subprime market, standards that now we see are just—we are horrified about, securitizations based upon very weak analysis by credit agencies, et cetera.

So, I mean, I think the point is that part of this debate we have heard time and time again has not just been about giving you the ability to set regulatory capital, which I think—and risk capital, which is absolutely important; it is also putting limits upon the growth of these entities in addition to that.

So let me ask the question. Do you think if you had as a financial regulator, most other financial regulators, the ability to set appropriate levels of capital, risk capital as well as basic capital, and you had access to the portfolios, to examine their portfolios, et cetera, that that would be sufficient without any type of arbitrary limits on the size of their portfolios?

Mr. LOCKHART. I believe that the portfolio should be focused on the mission and a major portion of it now is just buying their own securities. Seventeen percent of all the securities they issue they have in their own portfolios, and that is really not needed.

I believe that the House bill does required regulation that makes sense and does lay out some criteria, not all of which we agree with, but pretty much. And I think that makes a lot of sense, focus them on their mission of stability, liquidity, and affordability. We need to do that with their portfolios.

They have been growing very rapidly this year at 16 percent. One of the things we also need is to get the private sector back in, and that will take some confidence building. You may not know this, but about a quarter of their portfolios were those securities that Wall Street was issuing that you were talking about.

Senator REED. That raises another issue, which is, you know, they are a private enterprise in the marketplace. They are literally competing. And one could argue that maybe it was a race to the bottom, that some of their competitors were putting together securitization products which now look deeply suspicious in terms of their due diligence, in terms of, even worse accusations are being floated around, and that as we told them, frankly, to get into this market and as they went to the market and started competing, they were sort of pulled down.

I think there is an opportunity, particularly with Fannie and Freddie, either through your good offices or your colleagues, that if they can establish—raise the standard, you know, no prepayment penalties during reset periods, full documentation, et cetera, all those things—we can drive the market up. But my sense is—and maybe it was unintended consequences of the debate we have had over the last several years about reining in the GSEs, is we gave full rein to a bunch of actors right now that have—many have already entered bankruptcy or left the scene, and the damage is being sort of calculated and trying to be rectified.

Mr. LOCKHART. There is no doubt that over the last 2 or 3 years underwriting standards fell dramatically, and Fannie and Freddie to a certain extent had to chase that because they had the affordable housing goals, the mission to do it. The good news is because of some of the controls we had on them, they could not do too much in this area, and also because the managements realized that there were problems in the marketplace.

Going forward, one of the things we did is the bank regulators put together a non-traditional mortgage guidance and a subprime guidance. We made Fannie and Freddie adopt that for everything they buy, not only for mortgage-backed securities in their portfolios, but also if they buy private-label mortgage-backed securities. They now have to make sure every mortgage in that package complies with that guidance, which hits many of the things you were talking about. We are trying to help them instill a much higher standard than the market——

Senator REED. And I commend you for that, and I think the activities over the last several years that OFHEO has undertaken, mostly through consent, have been effective in, I think, providing a much higher standard that we need going forward. Now the challenge is if we get these standards aligned, if we give you, I think, the authority certainly to regulate appropriate capital, both risk-based capital and other capital, and then the next challenge is to deploy this reform, these entities, into the marketplace to start once again expanding originations, expanding access to loans. Because from the macroeconomic level, you know, if it keeps declining, that is not good news for anyone.

Mr. LOCKHART. As I said, they are expanding. They have expanded 16 percent this year.

Senator REED. And you do not have any problems in terms of that as an issue of safety and soundness?

Mr. LOCKHART. No. We even encouraged them to do mortgage-backed securities. Obviously, we had restraints on their portfolios, but at this point, they could grow their portfolios by about $100 billion for the next 6 months and not hit our constraints. We have not been constraining them through this year.

Senator REED. In fact, I would presume—may I presume that you would encourage them as a stimulus to the economy to keep expanding up to their capital limits?

Mr. LOCKHART. In a safe and sound manner.

Senator REED. Absolutely.

Mr. LOCKHART. That is the critical issue here.

Senator REED. Absolutely.

Mr. LOCKHART. Unfortunately, I go back to—on message again, if I may, but we need GSE reform to really be able to make sure that they have that safety net.

Senator REED. I do not think anyone is arguing about that, but I think, you know, we should stop and give you credit and your colleagues credit and because of, I think, obviously, self-interest, the entities, is that they took some prudent steps over the last few years to rein in some of the excesses that were quite obvious in the private sector.

Mr. LOCKHART. Yes. Thank you.

Senator REED. Thank you.

Chairman DODD. Let me just, before we turn to our next Senator, I just want to thank Senator Reed. That is a very important exchange that just went on.

Staff gave me a note here that Fannie and Freddie's share has gone up by 30 percent from the second quarter of 2007 to the fourth quarter in mortgage originations, while the market has declined from $730 billion to $450 billion. But for Fannie and Freddie, we would be looking at a very, very different situation.

Senator REED. And the lights would be out.

Chairman DODD. Yes. And, candidly, look, I mean, I—Jack said it well in a sense, and I will raise it myself later. You know, it was not just that underwriting standards got lax. They were not in place, despite legislation adopted in a bipartisan fashion by this Congress 13, 14 years ago. The concentration of the GSEs is important, but the suggestion somehow that the problem we are facing today was a GSE problem I think is to miss the point dramatically. Now, I am for a strong regulator and all of that, but the suggestion we are in the mess we are in today because of that is to miss the whole point. What has happened here, you know, we are now awash in sovereign wealth coming into the country with these bankers going around shopping all over the world to bring capital in to bail them out.

Mr. LOCKHART. No, I did not mean to suggest that they—that they are the problem. In fact, they are part of the solution.

Chairman DODD. Absolutely.

Mr. LOCKHART. A big part of the solution.

Chairman DODD. Well, we have to make that clear. It is very important to make that clear here, I think.

Mr. LOCKHART. I believe that and that is why I took this job, because I thought that they had such an important role to play in this economy. At the same time, we have to make sure that they continue to play that role in a safe and sound manner.

Chairman DODD. I agree. Thank you, Jack, very much for that. Let me turn to Senator Crapo.

Senator CRAPO. Thank you very much, Mr. Chairman.

I would like to pursue the question of whether we should roll the Federal home loan banks into the system a little bit further. Mr. Rosenfeld, we have testimony from other of the Finance Board members who argue that they do not believe that is the right decision. I guess it is fair to say that the Finance Board itself is mixed on this issue. Is that correct?

Mr. ROSENFELD. Yes, sir.

Senator CRAPO. One of the questions I have is that as we have been looking at the need for a strong, independent regulator, the types of things we are looking at are the need for a regulator that is able to independently finance itself so that it is not dependent on congressional appropriations; the ability for the regulator to place a GSE into receivership or conservatorship; the ability to have authority to approve new and existing businesses and business products that may come forth, or activities; the ability to set minimum capital levels; and things like that.

Does the Finance Board not already have all of those authorities?

Mr. ROSENFELD. Yes. We have quite extensive authorities. I think there are some—unquestionably, there are some things that would improve our situation, but what you have just mentioned, we have those authorities. Yes, sir.

Senator CRAPO. Well, the concern that I have is that there are clearly differences between the Federal home loan bank enterprises and the Fannie and Freddie enterprises. And any legislation that we pass would have to accommodate those differences in some way.

Mr. ROSENFELD. I agree completely.

Senator CRAPO. And as I see those differences, it appears we have different capital structures, different board structures, different approaches to the stockholder return and to the pricing for customers and so forth. And we also have a major difference in the fact that, as you say in your own testimony, the Federal home loan bank's business is secured lending, where most of the collateral is mortgage loans. The Federal home loan banks do not securitize mortgages, and direct mortgage holdings are only 7.2 percent of their total assets.

With these kinds of differences, how would we write legislation so that we would create one regulator that would regulate enterprises that have such significantly different structural approaches?

Mr. ROSENFELD. Well, I think for reasons which I attempted to articulate a few moments ago, I think that one regulator is the preferred way to do. Now, keep in mind that one regulator may have—for example, hypothetically you may have two or three people in charge of the organization as opposed to one. Director A may have primary responsibility over the home loan banks, Director B over Fannie and Freddie.

The question of how you regulate both seems to me to be the subsidiary question to the more important one, that there be one regulator for the GSEs who speaks with a common voice and executes a common fundamental policy, because at the end of the day, it is the Federal Government who provides this implicit guarantee for both of them. And I commend my colleagues on the Board for bringing to your attention as well as others' the differences between the enterprises and the home loan banks. And they are clearly there, and they clearly have to be honored and respected. But that to me is not a basis for not having a better overall regulatory structure that we have today.

And, furthermore, again, as I said in response to a question by Senator Shelby, I think that a more significant structure for the regulation would, in fact, over time provide unquestionably better leadership for both.

Senator CRAPO. Mr. Lockhart, do you want to comment on that at all?

Mr. LOCKHART. First of all, there are a lot of similarities. They are both dealing in the mortgage market. They are dealing with the same customers. They are borrowing money from the same people. They are dealing with the same risk. They both have examination teams. All firms are following the same accounting principles. There is a tremendous amount of similarities and synergies by combining these two groups and getting to a bigger, more prominent position, as well as a more significant place at the regulator's table. We are not involved in the bank regulators' Examination Council. There are a whole series of things, because we are so small, that we are not part of. So that is important.

As to the structure, the House bill has Deputy Directors for Fannie and Freddie and a Deputy Director for the 12 Federal Home Loan Banks. There are significant differences, as you said, and I think that combination structure will make it a very effective regulator going forward.

Senator CRAPO. Mr. Nason, I assume you agree with this, but you are welcome to pitch in if you would like.

Mr. NASON. Sure. The Treasury has very strong feelings that this is an effective structure. There are more symmetries that would bring a lot of utility to having a single regulator. And, frankly—of course, with all due respect to my colleagues—a stature increase in the regulators would be very beneficial for such very large, complex organizations that are very, very important to a critical part of our capital markets, which is the mortgage market.

Senator CRAPO. Just a last point on this, and that is, with regard to the Finance Board's activities in this current crisis that we have as well as the ongoing operations, nobody is suggesting that the Finance Board has had a failing or a lapse in some way, or a lack of power to deal with the issues that have come forth to this point, are they?

Mr. ROSENFELD. I think that we have exercised our authorities appropriately. I think that, as I said a moment ago, we do have the authorities for the most part that we need to conduct our affairs and keep the banks in a safe and sound situation. I do think that on behalf of my colleague, Mr. Lockhart, that OFHEO certainly needs strengthening in the areas which we have discussed at great length this morning.

Senator CRAPO. Thank you.

Mr. LOCKHART. To take an example of how they work together, some of the big banks are customers of both institutions. For instance, we see Citibank and Countrywide taking big advances over there. They are also some of the biggest customers of Freddie and Fannie. We may see, as we pass this conforming loan limit provision, that some of the advances they have been making will now come from them and come back to Fannie and Freddie as they take the jumbo mortgages that they are financing with the Federal Home Loan Banks and sell them to Fannie and Freddie.

There are a lot of synergies between these two, and one regulator looking over the structure makes a lot of sense.

Senator CRAPO. Well, thank you. I see my time has expired, so I cannot pursue it any further. But I would like to work with you on this issue as we move forward to be sure we can get it right.

Thank you, Mr. Chairman.

Chairman DODD. Yes, thank you very much, Senator.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. And thank you all for your testimony.

Mr. Lockhart, let me ask you, do you believe that the GSEs not only have an important role to play in the subprime crisis, but is there anything—do you think there is more that they could do to help? And are there any restrictions currently in place that are holding them back from helping more homeowners?

Mr. LOCKHART. They have a very important role to play in the subprime area, and the whole housing market, as we have been discussing. What their role has been is really helping people that maybe should have never been in subprime or are in better quality subprime and get into better mortgages, less risky mortgages. They have been doing that in a big way from refinancing those mortgages, and we are encouraging them to do that.

They have also been very involved in the Hope Now process and are trying to encourage modifications of loans to keep people in their houses.

As Senator Schumer mentioned, the whole idea of partial writedowns makes a lot of sense. We will be working with the two enterprises on that issue.

They have an important role to play, and they are going to continue to play it, but they also have to make sure that they do not take too high a risk. There are certainly a lot of subprime borrowers where the risk level is too high for them to buy those mortgages.

Senator MENENDEZ. Is there any restriction that you as a regulator look at and say, well, these restrictions are stopping them from playing the vigorous role that we want them to play?

Mr. LOCKHART. They develop their own underwriting standards, and we review the underwriting standards. We have not asked them to tighten the underwriting standards, but we continue to review them to make sure that they are safe and sound.

Senator MENENDEZ. Let me ask you this: Considering the missions of the GSEs to help low- and moderate-income families get affordable financing, do you think that—for example, this whole issue of new products as an essential part of reaching low-income and particularly minority communities, if we overregulate the process of getting new products to the market, aren't we essentially slowing down that process? And, second, as you answer that question, are we creating a disadvantage if we tell the world—if I were in the universe of lending money and I tell the world this is a new product that I am going to offer that may have some unique perspectives to it that would be attractive that I might want to offer it, and I tell the world 30 days before I put it out on the marketplace, am I not ultimately undercutting my ability by forecasting to all those in the universe who might give this and had not thought about it themselves?

Mr. LOCKHART. They really compete with each other more than anybody else, so it is really notifying Fannie, notifying Freddie and vice versa, because the banks themselves are the ones that are going to develop these products for them. They have to tell the banks what they are looking at for a new product.

There are issues whether it should be proprietary and not necessarily should it be exposed to the public right away. Certainly ones that have a significant public impact, there should definitely be an exposure. Certainly ones that are sort of at the edge of their mission, there should be an exposure. Certainly if they are looking at trying to get into the primary mortgage market, that should very much be subject to comment because they are not allowed to.

Senator MENENDEZ. All right. One last question. You made a statement with reference to capital levels for the GSEs that the level is too low. In the 1992 reform legislation and the recently passed House bill, they reaffirmed the congressionally mandated minimum capital levels for the GSEs. Can you elaborate upon that in terms of——

Mr. LOCKHART. What I was referring to is the minimum capital, which is 2.5 percent for assets and 45 basis points for their MBSs. In fact, in the House bill, what they did is they did what I think makes sense because it is what the bank regulators have. They gave the regulator the power to look at those, both the minimum capital and the risk-based capital, and adjust over time. And that is what really should be done. So what the House bill did was actually do what I was asking for, which is provide some flexibility on capital.

Fifteen years ago, when the law was passed, I do not think people were envisioning what has happened in the mortgage market today; that is, the credit risk we are seeing today. To me, that means that maybe those numbers were too low, and we may have to adjust them, especially in times like this.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

I apologize to Senator Martinez. I have my list here, and I went to Senator Crapo, and——

Senator MARTINEZ. Quite all right.

Chairman DODD. Please forgive me. Senator Martinez.

Senator MARTINEZ. No problem. Thank you very much, Mr. Chairman.

First of all, I want to, Secretary Nason, associate myself with the comments that Senator Shelby made. I think that I am suffering also under greatly diminished credibility from the Secretary of Treasury because to direct point-blank questions, the answers came back that, yes, he wanted to insist on a strong regulator, and, no, he was not in favor and would not be part of stimulus to have higher loan limits, conforming loan limits, for the GSEs. Within a matter of a few hours of that conversation, that is exactly what he did.

What I would like to ask you is: How does doing that enhance the safety and soundness? And what concerns does that raise in your mind as to the safety and soundness of the GSEs when it is not coupled with a regulator that, going back to the days that Secretary Snow and I were working together for a stronger regulator, before Fannie and Freddie showed us that they did not know how to bookkeep—that is before they had their crises. How is it that we are to feel more comfortable and more confident that the taxpayers of America are not at greater risk by increasing the conforming loan limits of Fannie and Freddie without a corresponding stronger regulator?

Mr. NASON. The way that I would answer that, Senator, is I think our strong preference would be to couple it with strong GSE regulation, and I think that the discussion of the stimulus package suggests that there were exigent circumstances in the mortgage market. It was crafted to be temporary. And I think that that does strengthen the case. Allowing the GSEs to move into a new line of business on a temporary basis does increase the need for a GSE reform package. And we are certainly hopeful and supportive that we will get one.

Senator MARTINEZ. Mr. Lockhart, let me ask you, as you look at the increase in the conforming loan limits—and, first of all, let me just say, Mr. Lockhart, I think you have done an exceedingly great job at OFHEO under extremely difficult circumstances. I would liken it to being in the circus main ring with a lion and a tiger and maybe something else thrown in there, with a hand tied behind your back and maybe with a weight around your left leg, and doing an admirable job.

Mr. LOCKHART. Thank you.

Senator MARTINEZ. So I commend you and I thank you. But what concerns come to your mind as we increase the loan limits, but not your ability to more carefully regulate these entities?

Mr. LOCKHART. We are adding more risk to companies that are already pretty well stretched, and to me that means that we need to make sure that we have a good capital regime, that we have the ability to make sure that what they are putting in their portfolio makes sense.

Another thing that concerns me is it is going to lessen their ability to meet their affordable housing goals. You know, a jumbo mortgage takes 3 times as much capital as their normal mortgage. So that is a concern to us.

But from a safety and soundness standpoint, the key thing is they are going to have to build models, they are going to have to put in rigorous discipline, because these are different risks that they have never dealt with before.

And so I think it is critical that we have all the powers of a strong regulator, not only to make sure they do this properly, but to make sure everybody else believes that they can do it properly.

Senator MARTINEZ. By giving them additional loan limits, we are enhancing their risk in an area where they have no expertise.

Mr. LOCKHART. That is correct.

Senator MARTINEZ. So that would make it even riskier than their normal line of business, would it not?

Mr. LOCKHART. That is correct. It is also a very concentrated risk too, in that over 50 percent is in California.

Senator MARTINEZ. Now, I know the housing goals are set by HUD, which is one of the problems. We need to do it all under the same roof. But why are housing goals important to GSEs?

Mr. LOCKHART. I believe one of the key roles GSEs play is for affordable housing. They have a lot of benefits being GSE's—no State income tax and being able to borrow more and cheaper than other AAAs. As such, there need to be goals. The goals have to be set realistically, and they have to be stretch goals. We need to make sure that they focus on them going forward, and that is a key reason why I think we need to relook at the portfolios as well.

Senator MARTINEZ. So affordable housing and loan limits in excess of $700,000 may not be equally compatible, even, frankly, in markets like Miami.

Mr. LOCKHART. The bill out of the House suggested that they were going to remove that from the calculation, but it still takes capital that could be put into affordable housing.

Senator MARTINEZ. So, in other words, they will have to skew their investments into areas of non-affordable and to the detriment of affordable, which may, in fact, make it impossible for them to meet the housing goals that have been set for them that are what their mission is about.

Mr. LOCKHART. Yes. I think that if you talk to the two CEOs, they would tell you they are going to have an extremely hard time this year meeting their housing goals.

Senator MARTINEZ. They used to tell me every year to tell me how difficult it was going to be to meet their housing goals when they were having their loan limits where they were, even lower than they are now.

What is important about the new product requirements? I understand the Senator from New Jersey was asking questions about the delay and maybe tipping the hand. At the end of the day, both of these entities are Government chartered for the purpose of enhancing affordable housing. And so at the end of the day, their competitiveness may not be the No. 1 overriding reason of why they exist. But why is the idea that new product ought to be reviewed by the regulator prior to the time when they just embark upon a new product?

Mr. LOCKHART. I agree wholeheartedly. It should be reviewed before and it should be reviewed from the mission standpoint and the safety and soundness standpoint together, to make sure that the product is both. Today, we only can do it from safety and soundness and, frankly, we are trying to do more and more going forward in that area. But, again, this legislation would help us do that in a much more systematic way.

Senator MARTINEZ. Thank you, Mr. Chairman. My time has expired, but I thank the chair.

Chairman DODD. Well, thank you very much.

Let me—I do not consider my role here to be defending the Secretary of the Treasury, but I—we have a tendency to stovepipe these issues. And while certainly they are very legitimate issues and we all, I think, agree here about the importance of a strong regulator, we are in a major economic crisis. The face of that crisis is the housing crisis, and the face of the housing crisis is the foreclosure crisis. And certainly there are very legitimate issues to be raised, in my view, about raising these limits to include some of these jumbo loans. We have a liquidity issue, and we are trying to respond to that here.

You could make a strong case that this stimulus package is not as strong as it ought to be, but it is going to be critically important, and we need to address the housing problem as part of this larger economic crisis.

And so I do not want to get in the middle of obviously what was said in rooms that I was not in, and I appreciate Senator Shelby's concerns and my friend Senator Martinez's concerns. But we have a major problem in this country, and we are acting as if things are relatively normal around here and we are just going to kind of deal with this thing in sort of technical perspective.

We have got a major, major problem in our country, and it is global, in effect, and we have got to act. And this is one of the places you have got to do not only to stimulate spending, but you need to address the underlying issue, and that is housing and foreclosures. And by getting more liquidity in the market by raising these loan limits I think helps in that regard.

The other issues are not illegitimate. I respect them. But given the balance between the two, I think it makes more sense at this juncture to try and do something about that to try and address this underlying problem that we have got to confront. That does not minimize the important points you are making, Mr. Lockhart, about this, but I think in fairness to the Secretary and others who are trying to do something about housing and dealing with the foreclosure problem, this is one of the ways in which you can get liquidity in the market. Don't you agree with that?

Mr. LOCKHART. Yes, I do, and it will help the market, and we need to make sure that Fannie and Freddie are strong enough to do it.

Chairman DODD. Well, we cannot separate these issues out like we are just sort of talking about a purely academic exercise.

Mr. LOCKHART. Hopefully, we can do them together. Hopefully, this bill can move quickly.

Chairman DODD. Well, that is why we are here today, and that is what I have told the Secretary. He raised the questions. I should let my colleagues know when I met with him. He asked the question whether or not we are going to move. I said we are having the hearing today, we are going to move on this, and we are going to get this done. But that does not mean you should hold up and not address the underlying problem that is having a major impact on our country, and a global impact. And the suggestion somehow we ought to wait on doing that I don't think is responsible.

Mr. LOCKHART. Yes, Mr. Chairman. What I was trying to say is that at this point we do need to strengthen them at the same time on different tracks. I sincerely believe that President Bush and Secretary Paulson strongly believe that we need GSE reform, and they want to do it as quickly as possible. And I certainly agree with that.

Senator MARTINEZ. Mr. Chairman, may I——

Chairman DODD. Senator Schumer.

Senator MARTINEZ. Mr. Chairman, just a quick comment.

Chairman DODD. Yes.

Senator MARTINEZ. I share your concern for the urgency of doing something about housing, and I understand and I agree with you that this package of stimulus may not do enough in the area of housing. However, I think to increase the risk of the GSEs may not be a smart way in the long term to increase liquidity and confidence in the market.

So my point would be that there are a number of other strategies that could be employed, perhaps safer, that would, in fact, get at the housing market, like the incredible inventory that exists.

So I share the concern on housing. I am not ignoring the problem.

Chairman DODD. No, no. Thanks.

Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman.

First, I fully agree with Chairman Dodd here. We have a crisis. We have debated GSE reform for a year. We have sort of been deadlocked. And to say, to use this huge housing crisis as hostage to move GSE reform, which is important but one is a mountain, and one is not a molehill, one is an average size hill, and it is backward priorities.

I think Secretary Paulson did the responsible thing, and I would say to my colleague from Florida, there are a lot of places where the conforming loan limit is just average, for average middle—Long Island, the average house costs $440,000, and that means the majority of homes are not right now available to the protections of Fannie and Freddie. And I do not think raising the conforming loan limit dilutes the safety. It is sort of a political shell game to say do not do the one before you do the other.

Again, I do not know the promises that Secretary Paulson made, but on the policy, he is doing exactly the right thing. I worked hard to see the conforming loan limits be put in, and they should be. We should do GSE reform, of course. But when you have a crisis—and, you know, it is sort of what I said about Fannie. When the house is burning, you do not say, well, I am not going to hose down the house until I sort of clean up the front yard. And that is what the problem is, in my judgment.

I would like to go to you, Mr. Lockhart. The issue of the 30-percent capital surcharge, don't you agree that allowing some flexibility in their capital will give the GSEs more ability to help struggling homeowners? I mean, that is sort of irrefutable.

Mr. LOCKHART. Giving them more flexibility in their capital will certainly help them do more mortgages. What we have to worry about, is not only the short term but the long term. We have to make sure that they are going to be there not just today and tomorrow but a year from now. It may take that long for us to get through this.

There have to be judgments and as I said to the Chairman, we will be looking at potentially releasing some of that 30 percent going forward as they continue to meet the goals and——

Senator SCHUMER. And do you have—because they have been meeting the goals. They have been good on this. And as I understood it, we were planning to do some release.

Let me ask you this, though: Do you have——

Mr. LOCKHART. There are two different things. On the portfolio limits, it is pretty clear from the agreements that we had imposing them, they will be released, assuming they get their financials out.

Senator SCHUMER. Right.

Mr. LOCKHART. But the capital was about their overall operational problems.

Senator SCHUMER. No, I understand. But let me ask you this: Let us assume we feel we can deal with the 30-percent capital surcharge and allow some flexibility. Do you have any comment on requiring—I mean, as I said in my opening statement, I would want some flexibility on the 30-percent capital surcharge, but only if Fannie and Freddie take that new room and use it to help aid the crisis. And at this point, given their reluctance to do that—they are always saying I will only do it this way but not that way or this way, I have lost some faith in Fannie and Freddie.

Do you have any problems sort of importuning them or even requiring them, if they got their capital flexibility that they very much want, to put some of that money into the kinds of things we need where there is a shortage of money and there is a capital crisis?

Mr. LOCKHART. As you know, we did loosen the——

Senator SCHUMER. Yes.

Mr. LOCKHART. We had discussions with you about that.

Senator SCHUMER. We did. You and I did, yes.

Mr. LOCKHART. We did loosen the portfolio limits in September. As part of that, we did ask them to fulfill their commitment for the $20 billion each on subprime. And they have.

Senator SCHUMER. Yes. Well, I am talking now about the capital requirement and giving that in exchange for more.

Mr. LOCKHART. Again, I think it has to be done in a safe and sound manner.

Senator SCHUMER. I agree.

Mr. LOCKHART. And that is the critical thing. But, yes, they can do more on affordable housing, and I think that is critical. And they can do more in subprime, not only in the refinancing area but in——

Senator SCHUMER. So you do not have an initial adverse reaction to some kind of either importunation—if that is a word—or requirement that they take this new-found flexibility and use it for helping relieve the crisis in one way or another?

Mr. LOCKHART. I am not sure that we have the powers to require it.

Senator SCHUMER. Well, what about us?

Mr. LOCKHART. They are government-sponsored enterprises.

Senator SCHUMER. Yes, and importunation works.

Mr. LOCKHART. It does.

Senator SCHUMER. OK. I want to go to just—you know, Mr. Nason mentioned the idea of GSEs playing a role in pushing lenders to accept fair market value for loans. Could you just elaborate a little bit on that?

Mr. NASON. Sure, Senator. What I was saying is one of the biggest road blocks to refinancings and modifications are you have a significant class of borrowers that their LTVs are too high, they are underwater. So the problem with getting those folks into a mortgage product that is sustainable would require a lender to take a writedown. And lenders have not been that willing to take a writedown.

Senator SCHUMER. Right. My time is running out, but you think basically this would work and be a very positive thing?

Mr. NASON. I think that getting lenders to take a writedown would be a very positive thing.

Senator SCHUMER. One final question, quickly, of Mr. Rosenfeld. Why hasn't the Federal Housing Finance Board joined its regulator colleagues in adopting the subprime mortgage lending guidance and holding collateral to the same standards that Fannie and Freddie have? As you know, I have had serious problems with what the Atlanta bank did, and I think I have been vindicated by the fact that they actually reduced the value of the collateral that they were holding, required more collateral for a smaller amount of lending. I do not understand why Atlanta was involved with Countrywide. I do not understand what the regulations were. I do not understand how careful they were. And if you would put these regulations into effect, we could make sure that things were much better done. So why won't you implement them?

Mr. ROSENFELD. We did. Senator Schumer, we have told all of the banks not to make—to accept loans or accept loans as collateral, or buy MBS that has loans, mortgage loans in it that does not conform to the FFIEC. We did not do it perhaps as quickly as we might have, but we have now done it. And I will tell you that most all the concerns you articulated about the conduct of the Atlanta bank and referring to Countrywide, I can tell you that we are confident that——

Senator SCHUMER. But you have not publicly adopted the regulations, have you?

Mr. ROSENFELD. We have told the banks.

Senator SCHUMER. But why don't you publicly adopt the regulations? This is not a game of whispering.

Mr. ROSENFELD. I am not——

Senator SCHUMER. Would you consider doing that?

Mr. ROSENFELD. Yes, we would consider doing that.

Senator SCHUMER. Thank you.

Thank you, Mr. Chairman. I know I went over my time.

Chairman DODD. No, not at all. Thank you, Senator Schumer, very much. Very good questions.

Senator Bennett.

Senator BENNETT. Thank you very much.

Sitting here through all of this, I do not have much new to add, but I think I have a slightly different perspective that I would like to pursue.

If I am a shareholder in either Fannie or Freddie, I have watched my share value drop from a price in the 50s down to a price in the 20s. I get my financial reports, whether they are completely compliant with SEC requirements or not, that tell me that Fannie lost $1.4 billion in the third quarter, and Freddie, $2 billion in the third quarter; both expect to lose money in the fourth quarter.

All of this talk about the contribution that the GSEs have made to stabilizing the market is terrific, and I agree with it. But are they going to survive? Two billion dollars in a quarter is not a trivial amount of loss, even for a company the size of Freddie Mac. And are we doing things in urging them to solve this problem and get into this area and take on this additional burden that might, in fact, cause these companies to go under?

Mr. LOCKHART. Certainly, we are very concerned about their safety and soundness. One of the good things that both of them did is raise significant capital in the fourth quarter and, unfortunately for their shareholders, cut their dividends. But it was a safe and sound thing to do.

Senator BENNETT. Yes.

Mr. LOCKHART. From the standpoint of the stock, for better or worse, a lot of other financial firms are having——

Senator BENNETT. I am not worried about the stock. I use that just to illustrate.

Mr. LOCKHART. Right.

Senator BENNETT. These are publicly held companies whose management, in addition to the mission and all of the other things we talk about, have a fiduciary responsibility to their shareholders. And as we push them—we, speaking generically of public officials—to perform all of these missions that are good for dealing with the problem, we are—are we—I am asking the question. Are we creating a tension there that would cause the CEO to wonder why he took the job? Because he has got his fiduciary responsibility to his shareholders, and if he does not meet that, he is not in a position to meet his social responsibility to the Government. And is there a tension between those two that we need to be aware of as we address this whole question?

Mr. LOCKHART. Certainly, there is some tension between being a public-owned company and a GSE. There are some benefits and there are some tensions.

From our standpoint, the pushing should only be done in a safe and sound manner. The whole idea of stretching them too far one direction or the other does not make any sense.

These companies have to earn an adequate return, or they are not going to survive long term. Certainly, as their regulator, one of the things we look at is their capability to have a decent return and decent earnings. And certainly that is a concern that we share with you, and we want to make sure—and hopefully this legislation will help—that if they are pushed to do more in one area, that they have the capital and powers to do it.

Senator BENNETT. Let us go to the underlining problem. It is the overhang, inventory overhang of housing in this country. We saw human behavior repeat what it has done for centuries. This is Tulip Time. When we had the tulip mania in Holland, it destroyed their economy for over 100 years when it finally shook out as people were spending an enormous amount for tulip bulbs, and then suddenly discovered that the greater fool that was going to buy the tulip for a higher price than they paid for it no longer existed, and the whole economy of Holland collapsed over tulip mania.

But the same human impulses that produced Tulip Time have produced one bubble after another. We had the bubble of overbuilding shopping centers that led to the savings and loan collapse. We had the bubble of the high-tech dot-com that produced the collapse in the early 1990s. And now we have had the housing bubble, and we can decry it all we want, but human beings are going to continue to do that, and there will be additional bubbles that will continue to come. They only work themselves out when the excess inventory is taken care of.

Are the kinds of things we are urging the GSEs to do now contributing to working down the overhang of inventory that is in the housing market?

Mr. LOCKHART. Certainly, there is an overhang and there is no doubt about it and, as you know, part of it is being corrected by less building and other things that are painful for the economy, and that will continue.

I think part of the role that the GSEs can play is to make sure that there is a mortgage market out there so the market does not overcorrect. I think what we need to do is obviously have this correction, but have it in a very orderly fashion and come out of it in an orderly fashion. And I think the role of Fannie and Freddie should be to add the stability as we go through this process. And, again, that is critically important that they stay that way and they stay safe and strong to help there.

They can help, as was discussed earlier, on loan modifications——

Senator BENNETT. Specifically, because my time is gone, would the increase in the limits that is in the House bill, that is in the stimulus package we are debating, contribute to that smoothing that you are describing?

Mr. LOCKHART. Potentially so in some markets. Some of the higher-cost markets, it gets very hard, but it might actually slow down some of the correction too. There is a tradeoff always. Some people say that—and I am not sure I believe this—if you go to these markets, you might prop up the housing prices and make it harder for it to be affordable. And part of what is happening here is we are correcting the affordability issue. We are getting house prices back to where people can afford to live in them, and certainly my children, who will be buying houses in the next 5 years, will probably benefit from some of this. But overall, I think the critical role that they play is to provide the stability and help smooth out going forward.

Senator BENNETT. Thank you.

Chairman DODD. Let me just, if I can, I wanted to—Senator Bennett always adds valuable input to any conversation we have in these matters, but just the numbers he is talking about. I suspect the witnesses know these, but just for the record, the current housing market is, of course, the worst since the Great Depression according to many. But the inventory of existing homes for sale stands at nearly 4 million units, almost double the number in January of 2005. This is equal to about 10 months of supply. The number of vacant homes for sale equals 2.6 percent, or 2.1 million homes of the stock of owner-occupied homes compared to the long-standing historical rate of 1.6 percent. In 2007, as a whole, single-family home sales fell 13 percent; new-home sales fell 40.7 percent, year over year in December. The weakest performance since 1981, just to add. That is our problem, a huge issue.

And I do not know whether we are doing this or not. I should check on this. I think part of the stimulus package has some tax incentives that might actually exacerbate this problem, which is not an easy thing to talk about, because obviously we are talking about a lot of jobs involved in this area. But it is one issue of supply and demand. Normally market forces would correct this, and if you are not going to have—if you are going to be exacerbating the supply and demand issue and then relying on a market response to this thing, I think a lot of——

Senator BENNETT. Stimulating and building additional housing is not necessarily a good idea.

Chairman DODD. No, and it is difficult, obviously, for people out there whose jobs and families depend on this stuff. It is a complicated issue. But we are not getting—the idea that the market is going to correct this problem with this continuing to exacerbate here—anyway, I do not mean to——

Senator BENNETT. No. Thank you.

Chairman DODD. Senator Shelby.

Senator SHELBY. I think it is going to correct the problem with pain and some suffering, as it always does. That is the market. But allow these house prices, as they fall, is going to create a market, too. Not maybe what a lot of people want. Is that right, Mr. Rosenfeld?

Mr. ROSENFELD. Senator Shelby, this is my third major credit crisis of my career, and I must tell you that the solutions to them are always the same. It is time and liquidity. And one of the biggest things we have to fear is falling house prices. It is certainly important. I think what we need to do is stabilize housing prices through the efforts of people like Chairman Bernanke and provide things specifically, and we will get out of this.

Senator SHELBY. I want to get into bond insurance. Mr. Lockhart, the bond industry has been under significant financial pressure, as we know. While the GSEs' charter indicate that the GSEs should purchase 80 percent loan-to-value mortgages, they can purchase higher LTV mortgages, loan-to-value mortgages, that carry private mortgage insurance. Is that correct?

Mr. LOCKHART. That is correct.

Senator SHELBY. Should the private insurers face further difficulties or downgrades, which we are all concerned about, are the GSEs adequately reserved for any possible losses here? And going forward, will the difficulties in the private insurance, that is the bond, affect the GSEs in terms of their ability to purchase higher loan-to-value mortgages?

Mr. LOCKHART. That is a very good question. Both Fannie Mae and Freddie Mac are spending a lot of time, and certainly we are, at looking at the financial condition of the bond insurers and the mortgage insurers.

Senator SHELBY. Explain just to the audience—I am sure a lot of them are very sophisticated—what loan-to-value, LTV mortgages mean. What does that mean?

Mr. LOCKHART. It means that the value of the house is $100,000 that they only can lend $80,000 against it. And what happened the last 2 or 3 years is almost everybody was borrowing much more than $80,000, in some cases all the way up to 100. So, they had to rely on credit enhancement under their charters, and that credit enhancement came from the mortgage insurers or——

Senator SHELBY. Private insurers.

Mr. LOCKHART. Private insurers.

Senator SHELBY. That a lot of us are concerned about their capital at this time.

Mr. LOCKHART. We are concerned about their capital. They, too, have taken on a lot of risk. In fact, to do a lot of the jumbos, they will probably need those mortgage insurers because many people will not be able to afford that 80 percent loan-to-value.

Senator SHELBY. Director Lockhart, of the $1.4 trillion portfolios retained by Fannie and Freddie, almost a fourth is in the form of private-label mortgage-backed securities. Is that correct?

Mr. LOCKHART. That is correct. More in Freddie than Fannie, but on average, a quarter.

Senator SHELBY. What do you believe is the GSEs' primary reason for holding such a significant amount of private-label mortgage-backed securities on their balance sheet?

Mr. LOCKHART. Most of them are subprime. About two-thirds are subprime and about a third are Alt-A. Most of them, or a lot of them had affordability characteristics, and they got credit toward the HUD goals for doing that.

Senator SHELBY. Isn't that a big risk there? What is the value of that portfolio? You know, it is not what is stated, obviously.

Mr. LOCKHART. When they got into that business, one of the things that they agreed to with us is they would only do AAAs. Now, some of them are no longer AAAs, but the vast majority still are AAAs. Yes, there is risk. Yes, the value is significantly less than 100 at this point, and it is something we are monitoring.

Senator SHELBY. Do private-label, non-agency mortgage-backed securities represent a unique risk to the GSEs that is different from the risk of holding their own mortgage-backed securities in portfolio? Is there a difference here? If so, explain the difference. I think there is some.

Mr. LOCKHART. Underlying their own and other people's mortgage-backed securities are mortgages. They did not do a lot in the subprime directly, so these mortgages under the private label are more risky than the ones they normally buy. On the other hand, there was this credit enhancement and other ways—at the AAA level they are somewhat cushioned so that the lower levels will take the hits first. But, yes, there is significant risk.

Senator SHELBY. You may be familiar with this, but a recent analysis by Credit Suisse raised some troubling numbers with respect to the GSEs' portfolios. Fannie Mae and Freddie Mac, according to Credit Suisse, held over $230 billion in securities backed by Alternate-A and subprime mortgages at the end of the third quarter of 2007.

Based on market prices for subprimes and Alternate-As, Credit Suisse estimated that Freddie Mac could face an $8 billion to $11 billion writedown and Fannie Mae an impairment of a writedown of $2.25 billion to $5 billion.

As the safety and soundness regulator—you, Mr. Lockhart—do these numbers square with your understanding of the risk posed to the GSEs from these holdings?

Mr. LOCKHART. A lot is based on how you price these securities. Unfortunately, at the moment they are not trading, so it is very hard to price them. There is a very wide bid-ask, if you will, and that concerns us significantly.

Certainly on a fair value basis——

Senator SHELBY. Well, sooner or later, they will be priced, won't they?

Mr. LOCKHART. We are hoping that the market does come back and people will start trading these securities. But, yes, it is an issue we are looking at. I think the Credit Suisse numbers are too high, but we are certainly looking at it. Certainly, they will price them as they look at their fair value. Whether they will have to take an impairment charge or not on these securities is something that they are looking at right now.

Senator SHELBY. Chairman Rosenfeld, as I understand it, bank advances can be offered using jumbo mortgages as collateral. What role have the Federal home loan banks played in providing liquidity to the jumbo market?

Mr. ROSENFELD. They do not buy them to be held in their portfolios. They only take them as collateral.

I am sorry. They do not buy jumbo mortgages to be held in their portfolios——

Senator SHELBY. But they will take them as collateral, though.

Mr. ROSENFELD. They take them as collateral. Yes, sir.

Senator SHELBY. Is that a significant difference? They take them as collateral but they do not buy them.

Mr. ROSENFELD. Well, but in the sense that they take them as collateral, they do provide liquidity for jumbo mortgages.

Senator SHELBY. OK.

Thank you, Mr. Chairman.

Chairman DODD. First of all, I want to thank all of our witnesses here. You have been very generous with your time here this morning. I am not going to engage in a second round right now, but I am going to leave the record open. We have got, obviously, Mr. Syron and Mr. Mudd to testify. And we will ask members to submit questions to you that they would have otherwise raised in a second round. Let me mention just a couple of things.

Mr. Dinallo, who is the Insurance Commissioner of New York, is going to be here tomorrow. Staff will be meeting with him to talk about what steps are being taken in New York dealing with the bond insurance issue.

Senator Shelby and I will be preparing a letter to go to the Treasury as well as to others that would have some direct relationship to this issue to ask what steps are being taken, what thoughts they want to share with us, whether or not there are any steps we ought to be taking here to deal with this issue that Senator Shelby has raised, I have raised, as well as others. This is a serious issue, as we all know, and it has got to be handled carefully. And obviously language we use needs to be judicious in this because that can have its own effects on the issue. So we are going to do that carefully.

And with that, I thank—we are going to move on this. I told Secretary Paulson and others, certainly Senator Shelby, that we are going to try and get this GSE bill done. There are some differences here, but I do not think that they are that wide. I think we care about some of the very basic things that are secure on. Senator Shelby and I have a long record of working well with each other, and I anticipate that is going to continue with this bill as well. So we will be looking forward to your input in the coming days here, but we intend to get this done. It is one piece of this, but I want to just go back to what Senator Schumer said as well. I think we need to keep it in proportion here and not have the tail wagging the dog here. We have got another issue in front of us here that demands some action immediately here if we are going to stem this tide of the present economic crisis. And this is important, and it is going to be an important piece in the long term as well as the short term of moving forward. And we intend to do that. Mr. Chairman, I will get the job done.

I thank all three of you for being here.

Mr. LOCKHART. Thank you, Mr. Chairman.

Chairman DODD. Let me invite Richard Syron and Dan Mudd to join us. I think the audience here is well known to both these individuals. Richard Syron is Chairman and CEO of Freddie Mac. He joined Freddie Mac in December of 2003 after a long and varied career in the financial services sector, including as Chairman and CEO of the American Stock Exchange, President of the Federal Reserve Bank of Boston, and the Federal Home Loan Bank of Boston.

I want to note that Freddie Mac helped lead the market with its decision last year to stop buying the 228 subprime ARM loans that have led to so much trouble, both for homeowners and the mortgage markets as a whole. That is the kind of leadership we expect the GSEs to continue to show as we continue to work our way through the current crisis.

Dan Mudd is President and CEO of Fannie Mae. He has worked at Fannie Mae since 2000, where he also served as Chief Operating Officer. Mr. Mudd was an officer in the U.S. Marines, with decorated combat service in Beirut, Lebanon, and we thank both of you for being with us. Good to see you this morning.

I am going to have you start in the order that I have introduced you. I am going to step out of the room for a second, but I will be right back. I have read the testimony so I know what you are going to say. So why don't you begin, Dick?

STATEMENT OF RICHARD F. SYRON, CHAIRMAN AND CEO, FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC)

Mr. SYRON. Thank you, sir.

Chairman Dodd, Ranking Member Shelby, and members of the Committee, I greatly appreciate the opportunity to appear before you today.

The last time I testified before this Committee was in 2005. It was obviously a very different time. House prices were robust and rising. Today they are falling. Housing was a strong contributor to GDP growth, adding another percentage to growth. Today, many fear we are headed into a recession.

Back then, markets were flush with liquidity and banks were reporting large profits. Now a number of lenders have gone out of business and we are in a global credit contraction, noted in today's Wall Street Journal in the case of U.K.

One bright spot is the conventional conforming market. The GSEs are one of the only sources of capital to invest in the mortgage market, which is exactly what is needed now. Senator Dodd brought early attention to the unfolding subprime crisis last spring and we responded with our commitment to buy $20 billion of subprime product. Today I am pleased to report we have bought about $42 billion in prime rate mortgages that finance people largely who found themselves before in subprime. This effort follows a period and a tradition of working to improve subprime practices by combating predatory lending.

As Senator Dodd noted, we were the first ones. Senator Dodd, I was just saying, as you noted, we were the first ones, actually a year ago right now, to put in place the anti-predatory features of lending.

As we all consider how to deal with the current subprime crisis, I am reminded of the lessons learned during the New England credit crisis in the early 1990s when I was heading the Boston Fed. During that time of economic distress, it was critical to find a way to balance the need for maintaining safety and soundness, while at the same time assuring adequate credit flows.

I would respectfully say we are in the same position today. And just so people know I am not a Johnny-come-lately since I have joined Freddie Mac on this issue, I have appended to my written statement, Mr. Chairman, testimony I gave before this Committee actually 17 years ago, which raised the same points on how these balances—particularly in the case of capital—had to be worked out.

This experience is very relevant to the debate we have today. Finding the right balance between preserving capital and providing liquidity is not easy and there are legitimate differences in view. But we all need to acknowledge that tradeoffs and balances are required. I know it may not be popular to mention shareholders in this context. But we have to keep in mind, and Senator Bennett noted this, that they are the first line of protection for the taxpayers. And without an expectation of a reasonable return, investors in the GSE system may just decide to take their money elsewhere. And that would be a very bad outcome for all of us, particularly the U.S. taxpayer.

Freddie Mac does support GSE reform and I want to underline that. We just want to be sure it strengthens the GSEs and the ability to meet their mission, particularly at this point in time, while keeping investors in the game.

As I described in my written testimony, there are two areas in particular that warrant the Committee's attention: capital and the affordable housing component of our mission. The subprime crisis set into motion a destructive cycle in which falling housing prices have exacerbated credit problems and generated losses. These losses, in turn, have eroded capital. One repercussion has been a wave of capital infusions, I might say from domestic and foreign sources. We have substantially added to our capital, as well.

To ensure that we can consistently provide liquidity in both good times and in bad—and we are needed more in bad—capital levels need to be consistent with the inherent risks that an institution's assets hold. If required capital is too high, the returns may be so diluted we would not be able to attract capital that does provide the taxpayer. If they are too low, they would threaten safety and soundness. It is a balancing act.

As for affordable housing, there needs to be greater flexibility to assure that the GSEs can meet its housing goals and all proposed commitments in all economic environments. We need to ensure that the goals, however well-intended, do not result in overstimulation of mortgage credit that leads to a situation like we are today, let's stimulate predation.

We look forward to working with the Committees and others to ensure we put families into homes they can keep.

In closing, let us remember that it was not long ago that many said the U.S. financial markets had matured to the point where we did not need GSEs. The street was going to take care of everything. This past year reminded everyone that we not only still need them, but we need them to be strong and vibrant. To do that, they have to have capital tied to their inherent risk and affordable housing obligations that make sense over the long run.

If I may say so, Mr. Chairman and Mr. Ranking Member, there were a number of, I thought, very good points raised by the previous witnesses and all of you in your questions. I think what they highlight is that people need to get together and work to resolve the tradeoffs that are inherently involved in that.

And excuse that, I do not mean that as an editorial comment.

Thank you very much for the opportunity to appear today, and I very much look forward to your questions.

Chairman DODD. Thank you very much.

Dan, thank you for being here.

STATEMENT OF DANIEL H. MUDD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE)

Mr. MUDD. Thank you, Mr. Chairman. Thank you, Ranking Member Shelby, for the opportunity.

We are committed to supporting your efforts to pass reform legislation in this Congress. Let me repeat that: we are in favor of regulatory reform legislation.

Fannie Mae has undergone significant change in recent years. At the same time, the mortgage and the housing markets have themselves undergone significant change. Fannie Mae has new management, and a completely revamped corporate governance and internal control environment. Only one hurdle remains, the filing of our 10–K later this month, for Fannie Mae to meet the 81 remediation measures called for in our 2006 consent order with OFHEO.

We believe that the internal improvements that we have made since 2005 have helped us meet an external challenge, which is maintaining liquidity, stability, and affordability in the prime conventional conforming mortgage market during this, a period of extraordinary stress. While the subprime and the jumbo market and other non-conforming markets have shrunk or shut down completely, the center of the markets where the GSEs have a large presence has performed relatively well.

Having said that, we are not immune. We are not immune from the disruptions in the market and we will take our lumps. In fact, as pointed out, we had a GAAP loss in the third quarter and we saw more difficult headwinds in the fourth quarter. And we expect 2008 to be some tough sledding.

Yes indeed, these are tough times, and that is when you want a Fannie Mae around. The GSEs have an important role to play in helping the market through these problems. Both companies are doing loan workouts and foreclosure prevention on a large scale. Chairman Dodd, you mentioned this in your opening remarks. Through our HomeStay initiative, Fannie Mae has successfully refinanced 68,000 subprime borrowers into safer prime fixed-rate loans. We continue to maintain a stable, liquid center of the mortgage market so that borrowers can access safe and affordable mortgages.

This market and our response are worth considering, I believe, as Congress and the Administration take up the issue of reforming the regulatory regime of the GSEs. The choices you make now should be durable and stand the test of time. We support the creation of a strong, independent bank-like regulator. Strength and independence, I think, are clear enough. Bank-like means we do support stronger power than our regulator has now. But at the same time, such powers and the skills that go with those powers should be comparable to and on a par with those of other modern regulators.

Our view of the principles that should guide regulatory reform has remained unchanged since I first testified before this Committee on April 20th, 2005. The dramatic changes in the housing market only reinforce our views of the key elements of regulatory reform. One, capital, Congress has established a statutory minimum capital standard for Fannie Mae and Freddie Mac that reflects the unique role of the Government-sponsored enterprises and the importance of capital in meeting their liquidity, stability, and affordability missions.

We support this Committee's reaffirmation of our minimum statutory capital requirement in S. 190 from the 109th Congress and the House's more recent reaffirmation in H.R. 1427. We also support the regulator's ability to increase our capital requirements when necessary to meet a clearly articulated safety and soundness concern. When such concerns are absent, legislation should enable our capital requirements return to the levels established by Congress. The normal capital levels established by Congress for normal times should be the norm.

Two, on portfolio oversight, we support regulation ensuring that the GSEs' mortgage portfolios are managed in a safe and sound manner. But regulation should not impose arbitrary limits, including a so-called systemic risk standard that does not exist anywhere else in bank supervision. To that end, we support legislation clearly identifying the bank-like safety and soundness factors that would guide regulatory oversight of our portfolio.

In the new product area, third, the bank regulation model also offers a guide. Banks keep regulators apprised of their new business initiatives through the examination process and by regular communication with their examiners. So should the GSEs. Particularly during times of extraordinary disruption and change, such as now, the GSEs have to move quickly to address the pressing needs of the primary market. A cumbersome pre-approval process, and public notice and comment, would be a step backwards.

Fourth, reform legislation should reinforce the GSEs' affordable housing mission. The GSEs' strong new regulator should set and oversee streamlined goals that reflect current market data and adapt to changing market conditions.

Fannie Mae also supports the creation of an affordable housing fund to be funded from GSE net income and integrated into a new, affordable housing goals framework. We should manage the fund, and we should be held accountable for the results.

In conclusion, Mr. Chairman, the housing and mortgage markets need certainty and stability at this time, and strengthening the oversight will provide an additional measure of confidence that the GSEs will be here to do our job now and in the long-run.

Thank you.

Chairman DODD. Thanks very much. Thanks to both of you. I will leave the record open, obviously, for the other members who were not able to stay around, so they will be able to raise some questions with you, as well.

Let me begin, if I can, Mr. Mudd, with you. In a presentation labeled "preferred offering roadshow" available on the website of Fannie, you noted that your market share is rising, your delinquencies are lower than the industry average. Your book of business has significant credit enhancements, and you are enjoying wider spreads on mortgage acquisitions.

And yet, Fannie appears to be designating whole counties, the so-called declining markets, for higher pricing, a practice some have called redlining in the past here, and a practice of also increasing charges to subprime borrowers who need access to your credit more than ever.

One, will these changes translate into higher rates for the borrower, in your mind? Will these changes, particularly those dealing with the declining markets, actually exacerbate downward pressure on prices by making credit harder to come by?

And obviously, the basic question here, and that is the GSEs, the very reason for their existence here, in part not only to serve an affordable housing issue, but to be counter cyclical at moments like this. It seems to me the very constituency we are talking about that is struggling right here, what you are suggesting, it seems to me, in the website is to exactly walk away from that very constituency and it raises serious alarm bells.

Mr. MUDD. Thank you, Mr. Chairman.

Two pieces. One piece is that on the adjustment for markets that are declining, what happens is that when our underwriting system detects a loan being underwritten in a market that is declining, it sends a message back to the primary lender that says take a look at this and get another appraisal.

The purpose of that is to make sure that in a declining market you do not put a borrower into a home that is under water on day one. So it is a piece of prudent underwriting, in our judgment.

I appreciate your comment, in the sense that it is very important to us to be sensitive to providing the liquidity in these markets. But the driver of it is the safety of the borrower and the driver of it is the safety of the loan, rather than anything else.

On the pricing, we are making sure that in a market where everyone would agree that there is more risk than there was before, that the pricing reflects the risk that is actually out there. And there is, I think we would all agree, more risk in the current market.

Chairman DODD. The self-fulfilling prophecy notion of all of this is troubling to me. You get into that downward spiral and trying to reverse that becomes terribly difficult and I am concerned about it.

You may have heard, and I will raise this with both of you here, that there were several of us here that raised the idea—Senator Schumer as well as myself—the idea of using your 30 percent capital surcharge. I think collectively it is around close to $20 billion, I think, between the two of you here, to actually provide those resources to assist this subprime borrowers to be able to have some workouts here that would allow them to stay in their homes.

These are owner-occupied. I am not interested in the speculating community at all. I mean, I am interested in that owner-occupied.

You may have heard me say, in fact I will be there on Monday. But in Bridgeport, Connecticut, the new mayor of that city indicated to me the other day that he may have 6,000 foreclosures in that city of less than 100,000 people. Needless to say, in a city—as so many are—that is struggles anyway economically to have that kind—and Richard, you will know, coming from New England you know what I am talking about here, that that can mean.

Anyway, share with us your thoughts on this and understand where we are coming from in this and the importance of engaging in this. What is your reaction to that request?

Mr. SYRON. Senator, Mr. Chairman, if I might, I think you raise the key question of how regulators should act, how lending institutions should act, and the reason that you have Freddie Mac and Fannie Mae. Quite honestly, if you look back a few years, there was enormous private sector participation in the market. Whether all of that was salutary in the end or not, pure private sector, is a matter for some dispute.

But we are there to be there in good times and bad. It is the only business line we are in. And we should act in a counter cyclical way.

But as part of that acting in a counter cyclical way—and I am sorry to be Johnny-one-note on this, but as you know, you were on the Committee when I testified before, 17 years ago. It is important that capital treatment not be pro-cyclical either. It is not a very good idea if you start to unreasonably raise capital on these institutions at a time when you need them to do more because the only thing they can do—if you want to have private shareholders, and never mind that, just to meet the capital—is to be more restrictive in lending.

Chairman DODD. Of course, to be the devil's advocate, the argument is, of course, if not requiring those capital standards in difficult times, you do not have the resources to participate.

Mr. SYRON. Well no, but I think the story is that for all financial institutions what you should do is husband and build capital in good times and have it there so you are able to meet more difficult times.

Chairman DODD. I agree with that.

Mr. MUDD. I would say, Senator, just to emphasize Dick's point, I think it is a balance, obviously, between making sure you are providing liquidity and maintaining safety and soundness. I look at the problem as having three groups, with respect to subprime. The top group is basically refinanceable into safer, fixed rate mortgages. We have done a lot of that.

There is a group at the bottom that is not going to be able to stay in their homes. And there are a number of things that can be done and a number of things that we have done to encourage people to do that as a workout on a peaceable, non-damaging to the consumer basis.

It is the middle group that requires the toughest thinking. How do you modify those loans to try to keep people in their homes? Our experience is that it is really a matter of trying to bridge them through this period. There are five or six different efforts that are underway—Hope Now could be one of them—that basically holds those payment levels constant so that homeowners can make their payments through the period of time until incomes go up, until home prices recover. We doing our part to make sure that we are making it as easy as possible for the servicers and the lenders to do those modifications is kind of the lever that we should be pulling on at Fannie Mae, certainly.

Chairman DODD. Why should I be anymore optimistic about this Hope Now Alliance, given the experience of—you were both in the room a year ago, or almost a year ago. We sat in this very room with the stakeholders and talked about what would need to be done in order to try to get these workouts moving. And yet, we hear reports of only a fraction of those numbers actually moving.

What should make me feel any more confident that I am going to see any more reaction now than I have seen over the last year?

Mr. MUDD. I will answer the question as directly as I can, which is that I think that it took the industry a while to gear up, to be able to move from a world that said that moving quickly through foreclosure was the right answer to a world that said foreclosure was absolutely the wrong answer. And it took the industry a while to get its processes turned around on that.

I do not think that the Hope Now answer, or the Fannie answer, or the Freddie answer is the magic bullet to this problem. Each is one piece of it that applies to a certain subset of borrowers and puts that key in that lock. There are many other things that could be done to give you, I think, Senator, more hope and encouragement that we are going to make progress.

Mr. SYRON. Senator, excuse me, Mr. Chairman, if I might add on to that. First, I agree with everything that Dan said.

Second, I think some of the ideas that have been put forward, the idea that you have raised for some sort of entity to deal with the bottom end of the market, I think a harsh reality we have to realize—because Senator Bennett talked about overhang in the market. There is an overhang in the market from units that have never been sold or are for sale.

But there is also kind of a second overhang. And that second overhang is we have got to admit we have put some people into houses, unfortunately, that probably did not belong in them and need to be renters.

Now the entity that you discussed could be, it seems to me, useful in that in converting to get through this process some of those units—we have a match. We have people that want to live in units and we have the units. But convert them for a period of time back into rental units with maybe a lease-to-buy type of process.

Chairman DODD. Mm-hmm.

Mr. SYRON. That is one thing I think could be pursued.

What Senator Schumer talked about on dealing with the seconds sort of issue, or dealing with avoiding foreclosure, I think is something that needs to be pursued. It is absolutely clear that when you foreclose on a unit there is a dead weight loss of 20 percent to 30 percent that everyone suffers from.

Chairman DODD. You know, there was—I was speaking to someone in the last couple of days who is fairly knowledgeable in this area and indicated to me that you were running into a significant—I think, a significant number of people who were not even able to meet the teaser rates because of what has happened to incomes, wages, and the like.

Are you seeing any evidence of this in your own data?

Mr. SYRON. Yes, sir. I think, unfortunately, we are headed into a period of economic softening. Whether it meets the test of a full recession or not is something that people can argue about later. But I think that there are people that are having trouble meeting teaser rates.

Now fortunately, the actions of the Federal Reserve will make, for some people, when the teaser rate ratchets up, less of a ratchet than it would have been before.

Chairman DODD. Let me just say, Director Lockhart noticed that your companies were both constrained from entering the subprime market over the past several years with the unfortunate exception of your purchases of private label securities because lending standards had gotten too lax and you could not compete for the business.

Now, however, the subprime market has all but ground to a halt, as we know. This creates an opportunity for the enterprises to enter the subprime market and establish a set of strong lending standards such as fully indexed loans without prepayment penalties, yield spread premiums, balloon payments, and the like.

I want to urge you to take advantage of this opportunity and I want you to comment on the possibility of doing that.

I should point out, by the way, and I think in the case of Freddie—I am not sure of Fannie—you led the way, in some ways, in terms of setting some of these standards of the underwriting requirements, and I applaud you for that. But give me some response to this set of suggestions.

Mr. SYRON. Senator—excuse me, Mr. Chairman, if I could, I think that we can buy originations. As you said, there have not been a lot of them so far. And we are in a tight situation, I will admit, at least our institution, for capital. That is why I think some of the issues you raised about the 30 percent are certainly well worth thinking about.

But we would be very willing to buy mortgages that met the new standards. Because I think to not meet the new standards would be irresponsible for the people—towards the people that were there before.

If I could quickly add one thing: on the ABS mortgages we bought into our portfolio, the subprime mortgages, we bought them in really to aid that market and to meet our goals. We do not, at this time, expect to take any losses on those mortgages. This is a market that does not trade. A lot of this is priced to different ABX indices, it gets very esoteric.

But when we look at the—no one can forecast the future. But when we look at what we expect in terms of foreclosure rates and what they call transition rates and difficulty rates, we do not expect to take losses on those.

Mr. MUDD. Mr. Chairman, my observation would be that there is nothing the matter with being a subprime borrower in this country. Certainly the notion is—a subprime borrower is somebody with a credit blemish. And if the notion is that if you have ever had a credit blemish in America, you are never going to be able to own a home in America, I do not think that is a place that we want to go.

So the question is under what standards should subprime lending be done? There are subprime borrowers that we have lent money to and we have put them in safe products, 30-year, fully amortizing fixed-rate loans. That is where the focus ought to be.

I think one of the reasons that these troubles started in the subprime market was that there were really no standards. The standard was do what needs to be done in order to get the loan made and at least get the person in the door for the first payment.

Chairman DODD. And then bundle them and sell them and get them out the door and you do not have any accountability.

Mr. MUDD. And not retain any of the risk, which is very different than the way these two companies operate.

The observation I would make, just as a corollary to your comment, was I think one of the other things we could do in this market is clean up the disclosures. It is hard enough for Dick and I to understand all the documents and all the provisions in our mortgages. But for first-time subprime borrowers that we have admitted already have a problem, we could certainly do worlds better in terms of disclosing clearly what they are getting into.

Chairman DODD. I want to turn to Senator Shelby, but I want to come back to you, Dick, on this, because the financial literacy issues, Fannie Mae seems to be walking away from some of that. And in light of this, I wonder whether they are going to come back to the earlier requirements for financial literacy, which was an important element in all of this.

Let me turn to Senator Shelby.

Senator SHELBY. I agree with both of you, that there is always going to be a subprime market, and there should be a subprime market. We have got to come up with some standards, or you have. And I know you have tightened some of the stuff.

Did I hear it right, I think Mr. Syron, you said that, that your subprime portfolio is working? It is performing, and so forth?

Mr. SYRON. Yes, sir. What we have in sub——

Senator SHELBY. If that is true, that is good. Go ahead.

Mr. SYRON. I am sorry.

Senator SHELBY. Do you have a subprime portfolio?

Mr. SYRON. We have about $100 billion in AAA rated subprime securities.

Senator SHELBY. And are they AAA rated because of private insurance?

Mr. SYRON. Some yes, and believe me, we look at that all the time. I was on the phone——

Senator SHELBY. We think about it, too, up here.

Mr. SYRON. But so far, actually—and as I said, anyone would be foolhardy to make promises about the future. But so far we have had good experience on that. And we are heavily subordinated. And so we think that all or almost all this is going to be money good.

Senator SHELBY. What about you, Mr. Mudd?

Mr. MUDD. Subprime represents——

Senator SHELBY. Are they subprime——

Mr. MUDD [continuing]. Less than 1 percent of our book. We do have——

Senator SHELBY. Are they performing?

Mr. MUDD. Yes, sir, they are.

Senator SHELBY. That is good.

Mr. MUDD. We have—we look at those very closely in terms of their performance. We look very closely at where they are rated but we do have our own separate rating system. There is credit enhancement, mortgage insurance, other forms of protection there. But we also stress test that and discount that, as need be.

We are watching it very closely. I think it is apt for you to point out that this is one of the risk areas in the market that we are in right now.

Senator SHELBY. Well, we want it to work.

Jumbo mortgages purchases. Congress, we have been talking about, is moving in the direction of allowing your companies to play a larger role in higher cost markets, such as California and others. According to an OFHEO analysis, mortgages associated with these higher cost properties may well pose greater credit risk, on average, than loans now purchased by the GSEs. These jumbo loans have different default rates, prepayment rates, and are more geographically concentrated.

Given the significant, if they are, operational risk your companies have recently had to fix in relation the plain, vanilla conforming loan market, how prepared do you believe the GSEs, Fannie and Freddie, will be to deal with these new and additional risks of jumbo loans?

Mr. MUDD. Thank you, Senator.

If you separate out the jumbo market and treat it as a distinct market from the prime, conventional conforming market, you can get very different answers. So the beginning of my response would be any participation in that market for us would be a continuation of the standards and the routines and the controls and the governance that we put around the prime market. I am sure you know that there are higher cost limits for us in Alaska, Hawaii, Guam. I am not sure how that happened. It was before my time, certainly.

But we looked very closely at that book, the same book, the same sort of working family type borrower, just in geographies that had more expensive homes. And we found out that by applying those same standards to the higher loan limits in those areas, their performance was largely indistinguishable.

So your point to me would be do not be doing vacation homes and mountaintop homes and all that. That is not, I think, what would be helpful to this market. A continuation of applying our standards to those areas of the near conforming market, you might say, that are relevant, I think we could provide some help there.

Senator SHELBY. With substantial down payments or whatever?

Mr. MUDD. With the very conservative credit standards that we know and love, Senator.

Mr. SYRON. Senator, might I just add to that?

Senator SHELBY. Sure.

Mr. SYRON. As an economist, I have to candidly admit that I think this is a good part of a stimulus package. I want to be clear, though, that this is not a boon in any way for the GSEs. Because, as people have noted, there could—may or may not be different credit characteristics. We would have to set up, at least in our case, different systems because you would not have—at least for the contiguous 48 States—the same loan limit. And that is kind of a bear to do and will cost us a lot of money to set up.

And to do all of this for a program that is going to only last a year, you know, we will do it because I think it is good for the country. But it is not going to be a great boon for us.

Senator SHELBY. Let me ask you this, I have been told that a $500,000 mortgage owned or guaranteed by either one of your companies would require twice as much capital for regulatory purposes as a $250,000 mortgage. And even if the GSEs securitized these jumbo loans, that also requires capital that would otherwise be used to support the purchase of a larger number of smaller loans.

Is this true? And would this cause you to look at it, as you have just referenced, a little differently?

Mr. MUDD. I think the capital would certainly be adjusted for the size and the risk of the loan.

One of the points to make, Senator, is that our average loan size is now, with a $417,000 loan limit, the average size is $140,000. So one of the impacts of this would not be that all of the loans would all of a sudden be $600,000. The average might move somewhat.

But I would feel that it would be very important for us to balance that out with a continued focus on the cheaper end of the market, the smaller end of the market.

Senator SHELBY. I will ask you both this. Does this recent increase in guaranty fees reflect your companies' reassessment of future credit risk or so forth?

Mr. SYRON. Yes, sir. The answer is yes.

Mr. MUDD. Yes, we can. [Nodding head.]

Senator SHELBY. Portfolio activities. Since the peak of the housing market in 2005, your companies have experienced a net increase in mortgage-backed securities outstanding of over $1 trillion, while your retained portfolios have been basically flat. Is that correct?

Mr. SYRON. Yes, sir.

Senator SHELBY. More or less?

Mr. MUDD. [Nodding head.]

Senator SHELBY. Have your companies been able to meet the liquidity demands in the mortgage market through your securitization activities? Or do you believe there remains considerable volatility in the conforming loan market?

Mr. MUDD. I would characterize it not as an either/or. Yes, we have been able to do some work providing continued liquidity. But we have had to make some tradeoffs and choices for products, residential apartments, military housing, that type of thing, that do not have a securitization market and so would need to be put into the portfolio. And we have had to make some choices about not doing some of those.

Mr. SYRON. Senator, if I could——

Senator SHELBY. Yes, sir. Go ahead.

Mr. SYRON. I might just add on, this becomes very applicable to the question you just asked about the jumbo loans.

Senator SHELBY. Sure.

Mr. SYRON. Because if we wanted to say very early, after whatever legislation is passed to do jumbos, by far the most practical way to do it—but it costs a lot of capital—would be to put them into the portfolio because you do not have to have developed all those things for the securitization machine. And we have been told by the dealers and people we sell to that these cannot be securitized into the packages that we have now because they have different characteristics. So we have to develop a whole new market.

And so just the point that, as I said, I think this is good policy economically. But it is not easy to do.

Senator SHELBY. Well, both of you have got your challenges here, have you not? Assuming this passes Congress?

Mr. SYRON. I would say so, sir.

Senator SHELBY. Mr. Mudd, in the fourth quarter of last year, Fannie Mae purchased—I have been told—just over $200 billion in mortgages. I understand that a fourth of those purchases were from Countrywide, who is a big mortgage banker. Given Countrywide's recent financial problems and loan performance, do you have any concerns as to the quality of those purchased? Do you review those accordingly? You all have your own standards, do you not?

Mr. MUDD. Yes, sir, we do. We review them. We review them very carefully. And as somebody becomes a larger counterparty of ours, we review them even more carefully.

In the case of most of those big institutions, we actually have staff that are onsite supervising and auditing the process. So we have a good deal of confidence in that portfolio.

We also think it is probably—it is positive, as a general matter, that the net counterparty strength between the Bank of America and Countrywide looks to be strengthened by this transaction.

Senator SHELBY. At least they have deeper pockets, do they not? Sure.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Let me just ask a couple of final questions, if I can, to both of you.

Mr. Mudd, on January 29th of this year the American Banker reported the following: it said "servicers claimed Fannie, in particular, adheres to restrictive rules that reduce the number of loans that may be modified. They say Fannie will not agree to a modification of a loan it has securitized until a loan has been delinquent for 4 months."

I wonder if you might explain if that is an accurate statement, this policy which seems to fly directly in the face of the direction everyone else is heading in.

Mr. MUDD. It was a fair criticism, absolutely, Mr. Chairman. We paid attention to it. It had a number of—it was kind of a Gordian knot to try to solve.

We have a product that we will be rolling out in a matter of a few days, which is called Home Saver Advance, which will enable us to work with the servicers to get in and rescue those loans, work with the borrowers long before they get in trouble.

So yes, your statement is accurate. It was an issue. We have paid attention to it. It will be fixed.

Chairman DODD. You know, we sat down together here a year ago and tried to talk about how we were going to get these things worked out. I am a little disappointed—I really was under the impression your people were really going to work at this thing over the last 10 or 12 months and discover here I am going through 4 months of delinquency. It is pretty clear what is happening here.

Mr. MUDD. That is not the first move that we have made, Mr. Chairman. We worked with our servicers. There were—we made a number of liberalizations in terms of the modification policy, let it work for a period of time, and then sat down with our seller servicers and discussed what was working, what was not. They gave us a list of an additional 18 things that they would like done. We said yes to all 18.

So we are focused on this. We are working on it and will continue to do more.

Chairman DODD. Let me ask you, as well, here, there are some observers of the markets' recent turns have suggested that one reason for what has occurred here is that loan down payment lending to moderate, low and low-income people is bad business for the lender, for the investor, and of course for the home buyer. I wonder if you agree with that statement?

Mr. MUDD. Senator?

Chairman DODD. Low down payment.

Mr. MUDD. Low down payment?

Chairman DODD. Yes.

Mr. MUDD. There is certainly more risk in a low down payment loan than a loan that has more equity in it on day one. But I view those types of loans being done prudently as an important part of our mission and an important part of our business.

Chairman DODD. Have you learned any lessons from doing this at all?

Mr. MUDD. I think the stress that we have seen in the market here suggests that at the front end of the system there was an underwriting assumption that was made that said home prices are going to go up always by some percent forever. It turns out not to be true. And a lot of people have learned lessons from that part of the process.

We have always, as you know, adhered to a standard that says if there is not 20 percent equity in the home on day one then some other form of credit enhancement is required. I think that is a recognition of the fact that that grubstake in the home is an important piece of it. But it also enables us to get to those borrowers that do not have that amount of capital when they enter into a mortgage.

Chairman DODD. One of the things you pointed out earlier, and I agree with you on this, and I think all of us do here. Obviously if any one of us, even those of us who sit up here and write a lot of this legislation, I suspect every time someone goes to a closing who is a Member of Congress they ask themselves whether or not they voted for this stuff that only an accountant or a lawyer could possibly understand. You made that point a few minutes ago, how common—even the two of you, as people who spend all of your days dealing with this stuff, this is complicated.

Fannie had a requirement for many years requiring counseling, particularly to first-time home buyers. And you stopped it. How does that square with this, all that we are talking about here, given the importance of that and understanding what it can mean to people going in? It seems to me that is, again, walking in the opposite direction of where we should have been going here to avoid the kind of pitfalls that many borrowers got themselves into.

Mr. MUDD. I think it is important, and I think there is an opportunity to put it back in. It is a good idea.

What happened was that when we put in the requirement, all the business went away from us. It is sort of like if you want to get car insurance you have to go to driver's ed, but you can get insurance from these guys without driver's ed. Everybody goes to the insurer that does not require driver's ed.

So now we are in a market where you can actually require counseling because, as was pointed out in the earlier panel, more of the business is coming our way. So we are working with a number of counseling organizations and others to make sure that people are more ready for this obligation.

And I think it ties in to the comment I made a minute ago, that better disclosure would also be helpful because you cannot guarantee that people pay attention during driver's ed.

Senator SHELBY. Mr. Chairman.

Chairman DODD. Yes, certainly. Go ahead.

Senator SHELBY. Can I ask——

Chairman DODD. Sure.

Senator SHELBY. With mortgage rates down right now, if you had good credit and a high interest rate, wouldn't this be a good time to looking to refinance your mortgage in America?

Mr. MUDD. I would recommend that to all our listeners today.

[Laughter.]

Senator SHELBY. Do you agree with that, Mr. Syron?

Mr. SYRON. Yes, I do, Senator. And I think that, you know, there is nothing wrong with the old fashioned fixed-rate 15- to 30-year mortgage with a decent down payment——

Senator SHELBY. Absolutely.

Mr. SYRON [continuing]. And somebody knowing what their obligations are going to be as they go forward.

Senator SHELBY. And those are what we call performing loans in the portfolio, aren't they?

Mr. SYRON. You got it.

Senator SHELBY. You got it, both of you.

If we stick to high standards or higher standards, we have fewer problems in the long run, do we not?

Mr. SYRON. Absolutely right.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman DODD. It is an interesting point because I am trying to recall this now from memory. But as I recall, something like 40 percent of the non-performing loans were not first mortgages, were not first time home buyers. These are refinances. Is that correct? Am I right about those numbers roughly? Was it 40 percent?

More than 50 percent.

Mr. SYRON. I think they were, but quite honestly, it may not be popular to say but what happened during the most of the go-go days, a lot of people developed products that might be attractive for the lender, did not end up being attractive for the borrower over the longer run. And they went out and they called people.

We have all been at dinner and been called by someone. I get called all the time about do I need another mortgage. And people were sold mortgages that were not to their advantage and because they were able to take out a lot of cash or do something else, it was a refi. But it was not to their advantage in the long run.

Chairman DODD. Senator Reed made the point earlier, Jack Reed did, and I agree, and I think Senator Schumer did, and I have, as well, that the irony, we are sitting down talking. I think all of us agree here, I have heard you say it as well, a strong regulator. There is no debate about that. I think we are going to get a good bill here.

But the irony is here, we are talking about a crisis now, with a highly regulated market out there—allegedly highly regulated—that collapsed in many ways because cops were not on the beat.

Mr. SYRON. Well, sir. Excuse me, Mr. Chairman, I think what happened is that a lot of the market moved away from the highly regulated——

Chairman DODD. I agree. I mean that, supposed to be highly regulated, the notion that it is highly regulated.

Mr. SYRON. Right.

Senator SHELBY. Mr. Chairman.

Chairman DODD. Yes.

Senator SHELBY. A lot of those people who moved into the other market are paying an awful price, are they not?

Mr. SYRON. They certainly are, sir.

Senator SHELBY. Investors and others.

Mr. SYRON. Yes, sir.

Senator SHELBY. Thank you.

Chairman DODD. But the borrower pays the ultimate price.

Senator SHELBY. Oh yes.

Chairman DODD. Those guys all get golden—most of them are leaving their jobs with $125 million golden parachutes. That person who is living in that house in Bridgeport does not get a golden parachute.

Senator SHELBY. We agree.

Chairman DODD. They just lost their home or are about to lose it. And that is the great tragedy. And these numbers are going to be in that million, several million range.

Mr. SYRON. Those people get a lead anchor.

Chairman DODD. Yes.

Thank you both. Appreciate it.

Mr. SYRON. Thank you.

Mr. MUDD. Thank you.

Chairman DODD. To be continued.

[Whereupon, at 1:22 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

Opening Statement of Senator Dodd
"Reforming the Regulation of the Government Sponsored Enterprises"

Remarks as Prepared:

The Committee will come to order. This morning's hearing is entitled "Reforming the Regulation of the Government Sponsored Enterprises." While this is the first meeting on this topic in the 110th Congress, I want to acknowledge that the Committee has established a substantial record on these issues which was developed through a comprehensive series of hearings organized by Senator Shelby when he was Chairman of this Committee. He has shown important leadership on this issue.

Because we have a number of members that are new to this Committee, I think it would be useful to remind people of the backdrop of these issues: A pattern of serious abuses and irregularities surfaced at Fannie Mae, Freddie Mac, and the Federal Home Loan Banks starting in 2003. These entities misstated their incomes by billions of dollars, and exhibited serious problems with their internal controls, accounting practices, and corporate governance. Today, Fannie, Freddie, and the Chicago Home Loan Bank are all still operating under regulatory agreements.

It is because of these very serious problems that we all agree that a new, world-class regulator, with broad powers like those of the banking regulators should be created to oversee the GSEs.

By the same token, we need to recognize the tremendous benefits that the GSEs have brought to the American people, to our communities, and to our economy.

For example, the widespread availability, nearly unique in the world, of a 30-year, fixed rate, prepayable mortgage is due in no small part to the existence of Fannie Mae and Freddie Mac. As a result, millions of Americans have achieved the dream of safe and stable homeownership that would have otherwise been out of their reach. This homeownership has been an engine of wealth creation for our nation, wealth that is measured in the hundreds of billions of dollars, wealth that homeowners may use to pay for a child's college education, to finance a secure retirement, or simply to get them over a financial rough patch.

Fannie and Freddie are two of the key drivers of the housing finance system that has created this wealth. Let me be clear – I will not be the one to preside over a legislative process that dismantles this system. I will pursue GSE legislation, and I will do so aggressively, but I will not do anything that undermines the foundations of this highly beneficial system.

Ironically, we have sat through hours of hearings over the years with witnesses repeatedly raising alarm bells about the risks Fannie and Freddie pose to the financial system. Yet, today, the only part of the housing finance system where credit is still flowing is in the GSE and FHA sectors. Everywhere else, mortgage credit is either unattainable, or incredibly expensive. One financial institution after another failed to effectively manage its risks and has been forced to seek capital infusions, often from foreign governments, to cushion the losses. Many financial institutions have gone bankrupt – but only after making bad loans that have turned the American dream into a living nightmare for millions of our hardworking fellow citizens.

In short, the system is under siege, and it is the GSEs that are riding to the rescue.

I know that there are some who take a different view of the matter; many are philosophically opposed to the very existence of these entities. Former Chairman Greenspan told this Committee very frankly that he was in this camp, and that he favored privatization.

In my view, it is time to get beyond this stale ideological debate. We need to get down to the hard work of crafting a balanced bill that will create the kind of regulator we all agree is needed.

By doing so, we will ensure the public that a credible regulator is on the job, increasing confidence in our system. We will also be able to demand, as an integral part of the process, that the GSEs strengthen and deepen their commitment to affordable housing. Senator Reed has provided us a framework for doing this. I intend to work closely with him going forward.

In addition, I believe the GSEs need to do more to help subprime borrowers get out of their abusive subprime loans and into safer, more affordable and stable products. Indeed, as Fannie and Freddie successfully address their accounting and management problems, I think it would be very helpful for them to devote a portion of the surplus capital they have been required to maintain for the purchase and workout of these troubled loans. As my colleague Senator Schumer noted last week, these are the times when the GSEs must live up to their public obligations. I intend to put them to the test on this.

Before I recognize the Ranking Member, I want to reiterate that we are in agreement in many areas, and I look forward to working with him, with our colleagues on the Committee, with our witnesses, and with other stakeholders to produce a strong, broadly balanced and effective piece of legislation.

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PREPARED STATEMENT OF SENATOR REED

"Reforming the Regulation of the Government Sponsored Enterprises"
February 7, 2008 at 10:00 AM in SD 538

Thank you, Chairman Dodd and Senator Shelby, for convening this important hearing.

As we know, the Government-Sponsored Enterprises (GSEs) are unique public-private partnerships. These counter-cyclical organizations, which were largely set up during the Great Depression to get the housing market going again, continue to prove their usefulness.

Whether through the recent advances or loans made by the Federal Home Loan Banks (FHLBs) to some of the country's biggest investors in subprime mortgages or the infusions of capital raised by Fannie Mae and Freddie Mac, which have helped keep the conventional mortgage market from grinding to a halt, the GSEs clearly still have a special role to play. Despite the seizing up of the subprime, Alt-A, and jumbo loan markets, investors continue to invest in mortgage-backed securities guaranteed by the GSEs and Americans still can obtain mortgages that meet the conventional loan limits.

As Congress considers additional ways that the GSEs might help with the current credit crisis in the mortgage markets, I think it is incumbent upon us to make sure the GSEs truly have a world-class regulator. The whole world is looking to us to pull ourselves out of what increasingly looks like a self-inflicted crisis, and clearly we need to be thinking not only about how to strengthen the regulation of the GSEs, but also about how to strengthen the regulation of many of the financial institutions and products that got us into this crisis in the first place.

In addition, as we consider giving Fannie Mae and Freddie Mac the ability to purchase certain jumbo mortgages to help re-liquify this part of the housing market it is incumbent upon us to make sure that Fannie Mae and Freddie Mac are not incentivized to cherry pick these larger mortgages at the expense of smaller mortgages at the lower end of the mortgage market. We are giving them a whole new line of business and entry into a market they have never been in before, and now more than ever it needs to be clear that the GSEs have a robust affordable housing mission as well.

I introduced S. 2391, the GSE Mission Improvement Act, three months ago, to emphasize that with government benefits and guarantees come additional responsibilities. This legislation would require Fannie Mae and Freddie Mac to set aside funds for an Affordable Housing Program.

Sixty-five percent of this set-aside would go towards an Affordable Housing Block Grant Program. This funding would be allocated to the states by formula grant to help address the current subprime mortgage crisis. These grants could be used to facilitate loan modification and refinance options for low- and moderate-income borrowers facing foreclosure. Some of the funding could also be used to help low- and moderate income homebuyers purchase properties that have been foreclosed upon to help stabilize neighborhoods. Currently, the Federal Home Loan Bank of San Francisco has developed a pilot program to do something like I have suggested in this legislation--to use part of its affordable housing set-aside to refinance low- and moderate-income households with non-traditional or subprime mortgages into fixed-rate, fully-amortizing 30 year mortgage.

After 2008, this block grant funding would be distributed by formula to the states for the development, construction, and preservation of housing for very low- and extremely low-income families. This funding would complement other federal and state programs, such as the HOME Investment Partnerships and Low-Income Housing Tax Credit programs, to bring down costs enough to primarily target the income group most needing housing that is truly affordable to them, extremely low-income renters.

The other 35% of this funding would be allocated for a Capital Magnet Fund. This funding would go out through competitive grants for financial activities that leverage affordable housing development, construction, and preservation for low-, very low-, and extremely low-income families

S. 2391 also would strengthen Fannie and Freddie's Affordable Housing Goals. In particular, it would align their goals with current Community Reinvestment Act income targeting definitions, which I believe should help the lower end of the conventional market become more liquid.

Finally, this legislation would create a new statutory duty for Fannie Mae and Freddie Mac to serve "underserved markets" that lack adequate credit through conventional lending sources such as Manufactured Housing; Affordable Housing Preservation; Subprime Borrowers; Community Development Financial Institutions; and Rural Housing. I give teeth to this provision by making compliance with this duty subject to Section 1336 enforcement provisions.

I urge my colleagues to cosponsor this legislation and to help make it an integral part of any GSE reform that we move forward.

Again, I thank the Chairman and look forward to hearing from the witnesses.

PREPARED STATEMENT OF SENATOR CASEY

Thank you, Mr. Chairman, and thank you for holding this hearing.

As recent events have shown us, the housing market is at the core of the United States economy. Ensuring the continued stability of the housing market is one of the best ways to ensure continued economic growth and a higher quality of life for our citizens. Reforming our Government Sponsored Enterprises - Fannie Mae, Freddie Mac and the Federal Home Loan Banking system – will help to maintain their credibility, ensure the long-term strength of the housing market, and help stabilize our economy.

Since the accounting scandals of 2003 and 2004, both Fannie and Freddie have come a long way. Under new management, they have updated their business practices, improved their internal accounting systems, and regained much of their reputation.

During the current housing crisis, Fannie, Freddie, and the FHLBs have been a stabilizing force during a very troubling time in the mortgage markets. If another scandal were to happen again at any of the GSEs, it would undermine the hard won credibility that they have regained and shake already unstable housing markets. This is why we need to act quickly to create a strong, unified regulatory structure that will to ensure that the GSEs bring stability to the mortgage market and continue expanding housing opportunities for all families.
Both Freddie Mac and Fannie Mae were among the first to identify and respond to the subprime crisis. I'd like to thank them for the steps that they have taken already to modify loans and prevent foreclosures.

In 2006, Freddie Mac helped 2,098 Pennsylvania families avoid foreclosure while Fannie Mae helped another 2,700. The GSEs help bring millions of dollars in capital into our cities and our states to help families purchase homes. I hope we can all work together to create a unified, sensible regulatory structure that allows the GSEs to continue bringing the world's capital into our local neighborhoods.

At the same time, the GSEs must acknowledge the unique role they play in our financial market in which there is a crisis of confidence sweeping the country. A few years ago, numerous problems were uncovered with Freddie and Fannie and the FHLBs. I appreciate that all three have gone a long way toward correcting those deficiencies, but again, significant failures like those of 2003 shake consumer confidence and we have to be especially mindful in the current economic environment of how important public trust is to our financial institutions. I urge you to go back to your offices after this hearing, to be creative and innovative, and to keep coming up with ways to help this nation's homeowners who are struggling to stay in their houses, keep their jobs, feed their children and send them to college. Whatever the GSEs can do to restore confidence and help these families sleep a little better at night, they must do.

We need a unified, politically independent regulator for all of our housing GSEs. The current system is too fragmented between HUD, Office of Federal Housing Enterprise Oversight (OFHEO), and the Federal Housing Finance Board (FHFB). The new regulator should be free from the appropriations process and given broad authority over both mission and safety and soundness. A regulator with broad authority can ensure coherent regulation, better enforcement, and a more aggressive effort to expand affordable housing at all the GSEs.

Statement of Senator Evan Bayh

Senate Committee on Banking, Housing, and Urban Affairs
"Reforming the Regulation of the Government Sponsored Enterprises"
February 7, 2008

Clarifying Federal Home Loan Bank Securitization Authority

Chairman Dodd, thank you for holding this important hearing on reforming the regulation of our housing government sponsored enterprises.

These GSEs play a critical role in providing liquidity, and lowering the cost of financing, for housing in America. And during these past few months, we have been painfully reminded of how important these issues are to individual American families and our entire economy.

I'd like to briefly mention the critical role the Federal Home Loan Banks – often referred to as the "third GSE" – have played in helping stabilize the home mortgage market during this recent crisis. I'm pleased to note that one of the Home Loan Banks is located in Indianapolis.

For example, during the third quarter of 2007 – the most recently data available – the Federal Home Loan Banks provided approximately $825 billion in liquidity, known as "advances," to their member financial institutions, a staggering increase of nearly 30% over the previous quarter. This growth in liquidity lending provided some relief to the financial markets during the sub-prime mortgage crisis. Importantly, these advances were provided mostly at rates considerably lower than would be otherwise available to the retail banking institutions. Were it not for this additional liquidity, the problems that continue to plague the home mortgage market would be even greater.

In addition to providing advances to their members for the purpose of funding mortgages, many Federal Home Loan Banks also buy mortgages from member community banks through various mortgage purchase programs. These programs have been quite successful at providing liquidity at competitive rates for their members, and Home Loan Banks currently hold over $90 billion of conforming home mortgages on their balance sheets.

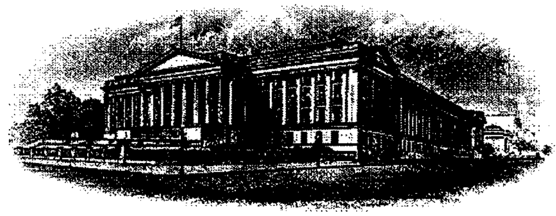
To ensure that community banks can continue to rely on their Home Loan Banks to be a viable mortgage purchaser, the Banks must have the ability to mitigate risk by moving these mortgages off their books by securitizing and selling them. The Chairman of the Indianapolis Home Loan Bank testified last Congress before this Committee discussing the benefits of such a risk mitigation tool.

I should note that the Treasury Department and members of this Committee have often focused on the need to have Freddie Mac and Fannie Mae mitigate risk by reducing the size of their mortgage portfolios – precisely the steps the Federal Home Loan Banks would like to take to ensure their own continued safety and soundness.

Any expansion of the role of Home Loan Banks in purchasing mortgages must not jeopardize the efficacy of their advance lending, which is a unique and important facility. The advance book has been a pillar of community bankers' access to capital, and it should be preserved as such. Furthermore, a securitization initiative by any Bank should be accompanied by careful safety and soundness controls so as not to place undue risk on the Home Loan Bank System as a unit.

I understand that existing law provides ample authority for the Federal Housing Finance Board – the current regulator of the Home Loan Banks – to authorize new funding techniques for the mortgage programs; however, the Board has sought guidance from Congress on this issue.

I look forward to working with the Chairman and the other members of this Committee as we consider GSE reform legislation to ensure that it is clear that any Home Loan Bank regulator has the authority to allow Federal Home Loan Banks to securitize and sell mortgages.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10 a.m. (EST), February 7, 2008
CONTACT Jennifer Zuccarelli, (202) 622-8657

ASSISTANT SECRETARY DAVID G. NASON
TESTIMONY ON REFORMING GSE REGULATION
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

WASHINGTON - Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to appear before you today. I very much appreciate the opportunity to present the Treasury Department's perspective on regulatory reform for our nation's housing government sponsored enterprises (GSEs): Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBanks).

Overview of Housing and Mortgage Market Activity

The U.S. economy is diverse and resilient, and our long-term fundamentals are healthy. Yet, economic growth has slowed and the risks are clearly to the downside given current conditions in the housing, credit, and energy markets. Issues related to housing and credit markets bring us directly to the topic of today's hearing.

This Committee is very well aware that the housing and mortgage markets are going through a transition period that is exerting stress on homeowners. The current housing downturn comes after eight years of exceptional housing price appreciation and the housing market is likely to remain weak well into this year and potentially beyond 2008.

A vitally important aspect of working through the current transition in the housing market is ensuring that mortgage credit remains available for both home purchase and refinance transactions. On August 31, 2007, President Bush announced a series of efforts to help mitigate challenges in the housing market. Last week, Under Secretary Steel appeared before this Committee to outline our progress to date and to describe our ongoing efforts to help reduce the number of preventable foreclosures. We appreciate the work and cooperation of the Congress in this area and ask that the Congress pass Federal Housing Administration (FHA) modernization as soon as possible in order to increase opportunities for homeowners to refinance into more sustainable mortgage products.

The Administration also recognizes that the GSEs have played an important role in making credit available to current and prospective homeowners. Since year-end 2006, Fannie Mae and Freddie Mac have increased their outstanding mortgage-backed securities (MBS) by over $600 billion. In addition, outstanding advances of the FHLBank System increased by $184 billion in the third quarter alone, providing additional liquidity and a source of funding to support the lending activities of insured depository institutions and other FHLBank members.

The Time for Regulatory Reform of the Housing GSEs is Now

A key element of the housing GSEs' public purpose is to enhance liquidity in the mortgage market. If we expect the housing GSEs to perform that mission, we must demand that they have a regulatory structure that is appropriate for the importance of the mission and the risk that it entails. It is the Treasury Department's view, and it appears to be generally recognized, that the housing GSEs' regulators have neither the tools, nor the resources, to deal effectively with the current size, complexity, and overall importance of these enterprises.

We acknowledge and commend the housing GSEs for adding some degree of stability to the current mortgage market. Of course, they have had their own problems in recent years and are not immune to problems that are currently plaguing the mortgage market.

The well documented accounting and corporate governance problems that emerged first at Freddie Mac in 2003 then later at Fannie Mae in 2004 raised fundamental questions about the risk management practices at both companies. In response to these issues, the Office of Federal Housing Enterprise Oversight (OFHEO) has entered into supervisory consent agreements with the boards of directors at Fannie Mae and Freddie Mac. These supervisory agreements, which were consummated in December 2003 for Freddie Mac and in September 2004 for Fannie Mae, require the enterprises among other things to improve their internal controls and risk-management operations. While Fannie Mae and Freddie Mac have made substantial progress in addressing these issues, as of December 27, 2007, OFHEO still had supervisory concerns about the internal control and operational weaknesses at both enterprises.

In addition, the FHLBanks were not immune to similar risk management issues, as the regulatory actions associated with problems at the FHLBank of Chicago and the FHLBank of Seattle illustrated. The severity of the problems in the case of the FHLBank of Chicago is evident as discussions are underway regarding a potential merger with the FHLBank of Dallas. This would be the first merger within the FHLBank System since 1946, when the FHLBanks of Los Angeles and Portland were merged to create the FHLBank of San Francisco.

More recently, much like other financial institutions involved in mortgage finance, Fannie Mae and Freddie Mac have experienced various levels of stress in the current mortgage environment. For example, in the third quarter of 2007, Fannie Mae and Freddie Mac reported losses of $1.5 billion and $2.1 billion, respectively. Furthermore, in the fourth quarter of 2007, Fannie Mae and Freddie Mac raised preferred equity capital in the amount of $7.9 and $6.5 billion, respectively. These recent increases in equity capital help to keep the enterprises above their regulatory capital minimums in what has been, and what many expect will continue to be, a difficult operating environment in the near-term for entities in the mortgage market.

All of these factors point to a clear and urgent need for completing housing GSE regulatory reform, and we thank this Committee for taking this important step toward this goal. The Treasury Department's core objectives for housing GSE regulatory reform are: (1) the need for a sound and resilient financial system, and (2) increased homeownership opportunities for less-advantaged Americans. It is paramount that the housing GSEs properly manage and supervise the risks they undertake and that a strong regulator oversee their operations. Otherwise their solvency could be threatened and this could have a negative impact on the stability of other financial institutions and the overall strength of our economy.

Necessary Powers for Financial Regulation

Throughout the debate on housing GSE regulatory reform, the Treasury Department's focus has been on ensuring that the new regulator has all of the powers, authority, and stature required to perform its mandated function. In this regard, the new regulator's powers should be comparable in scope and force to those of our nation's other financial institution regulators.

In terms of comparable powers, we must ensure that the new housing GSE regulatory agency is not encumbered by the current restrictions that are placed on OFHEO. Many of the following key elements of housing GSE regulatory reform have been debated in recent years:

- *Capital Requirements* – Under current law, the minimum capital requirements for the housing GSEs are fixed in statute, and the risk-based capital requirement for Fannie Mae and Freddie Mac is based on a highly-prescribed stress test that is set forth in statute. These limitations are inconsistent with the ability of other financial regulators to set both minimum and risk-based capital requirements. The new housing GSE regulatory agency must have the authority to set both minimum and risk-based capital requirements.

- *Receivership/Conservatorship* – Under current law, OFHEO has the authority to place Fannie Mae or Freddie Mac into conservatorship but not into receivership. Should such circumstances arise, the new housing GSE regulatory agency must have more than the powers associated with conservatorship. In particular, the new regulatory agency must have all the receivership authority that is necessary to direct the liquidation of assets and otherwise direct an orderly wind down of an enterprise. The new regulatory agency must also be required to take mandatory receivership actions under certain circumstances. Such receivership authority can be established in full recognition that the Congress has retained to itself, in the case of Fannie Mae and Freddie Mac, the power to revoke a charter. Providing the new regulatory agency the ability to complete an orderly wind down of a troubled regulated entity also encourages greater market discipline by clarifying that investors may suffer losses. Enhanced market discipline is essential to promoting safe and sound operations, which is consistent with maintaining the GSEs' role in our housing finance system and protecting our broader financial system from problems at a GSE.

- *New Activity Approval and Mission Oversight* – Under current law, the Department of Housing and Urban Development (HUD) is responsible for approving new programs, setting housing goals, and overall mission oversight of Fannie Mae and Freddie Mac. The authority for approving new activities of Fannie Mae and Freddie Mac and ensuring compliance with their mission must be transferred from HUD and combined with the other supervisory/enforcement powers of the new housing GSE regulatory agency. This authority is consistent with availability of one of the central tools that every effective financial regulator has – the ability to say "no" to new activities that are inconsistent with the charter of the regulated institutions, with their prudential operation, or with the public interest.

- *Other Aspects of Enhanced Authority* – Housing GSE reform legislation also should include additional measures in order to provide the new regulator with authorities comparable to other U.S. financial institution regulators. Such enhancements should ensure that the GSE regulatory agency has: (1) independent funding outside of the appropriations process; (2) independent litigating authority and other related powers; and (3) the full set of regulatory and enforcement tools.

- *Government-Appointed Directors* – The Federal government should not be involved in the appointment of directors to the boards of Fannie Mae, Freddie Mac, and the FHLBanks. Consistent with long-standing principles of corporate governance, directors of the housing GSEs have a fiduciary responsibility to shareholders. The government appointment of directors does not change this fiduciary responsibility, but does give the impression that the government may have a say or influence in the operation of the housing GSEs. That is not the case, and this should be corrected to improve corporate governance and to clarify further that the housing GSEs are not backed by the Federal government.

- *Combining the Regulatory Authority of the Housing GSEs* – The FHLBanks are regulated by the Federal Housing Finance Board. The FHLBanks should be placed under the same regulator with Fannie Mae and Freddie Mac, and this new regulatory regime should be structured to take into account certain special differences between the FHLBanks and the other GSEs. This would enhance the critical mass of financial expertise needed to oversee the GSEs. At the same time there are many common synergies, such as the FHLBanks' investments in mortgages and MBS, and the mortgage investments of the other housing GSEs. In addition, combining regulatory authority over all of the housing GSEs under one regulator has the potential to increase the stature of the new agency and better enable it to deal with these large and influential companies.

The housing GSE regulatory reform bill passed by the House of Representatives (H.R. 1427) addresses many of these aforementioned core reform issues in an adequate manner. However, additional elements of reform are necessary to address the GSEs' particular characteristics.

Additional Key Elements of Housing GSE Regulatory Reform

In addition to addressing the fundamental shortcomings in the current GSE regulatory structure, it is just as important that the new regulator have the appropriate authority to consider the unique characteristics of the GSEs and their housing missions. The housing GSEs were created to accomplish a mission, and they were provided a certain set of statutory benefits to help in carrying out that mission.

For example, in terms of specific benefits, the housing GSEs are not subject to state or local taxation and they have access to a line of credit with the Treasury Department. Fannie Mae and Freddie Mac each have a \$2.25 billion line and the FHLBank System has \$4 billion line, which pales in comparison to the size of their debt obligations –\$770 billion each for Fannie Mae and Freddie Mac and \$1.1 trillion for the FHLBank System as of September 30, 2007.

The GSEs also benefit from the market's misperception that the U.S. Government guarantees or stands behind GSE obligations. This misperception, unfortunately, results in preferential funding rates being provided to the GSEs. There are differing views on the precise amount of this benefit, but there is general agreement that the benefit exists. It is this benefit and a lack of effective market discipline that largely drove the rapid expansion of the retained mortgage portfolios of Fannie Mae and Freddie Mac throughout the 1990s.

Fannie Mae and Freddie Mac operate in the secondary mortgage market by providing credit guarantees on mortgage-backed securities (MBS) or by directly investing in mortgages and mortgage-related securities through their retained mortgage portfolios.

In the credit guarantee business, Fannie Mae and Freddie Mac generally enter into swap agreements with mortgage lenders under which individual mortgages are transformed into MBS guaranteed by the GSEs. Fannie Mae and Freddie Mac also have the ability to purchase mortgages and package them into MBS.

In the mortgage investment business, Fannie Mae and Freddie Mac issue debt securities to fund an investment portfolio of mortgage-related securities. In comparison to the credit guarantee business where credit risk is the main exposure, the mortgage investment business involves both credit and interest rate risk. As has been evident during the recent problems in the mortgage market, liquidity in the conforming mortgage market has remained relatively stable. This has occurred primarily through the GSEs' credit guarantee function and increased levels of mortgage securitization as the size of their retained mortgage portfolios essentially has remained unchanged since 2005. While credit risk has been increasing and should not be taken lightly, especially in the current mortgage market environment, the Treasury Department continues to believe that the mortgage investment businesses of Fannie Mae and

Freddie Mac present the greatest potential risks over the long-run. At the same time, the mortgage investment business has a much more tenuous connection to the GSEs' housing mission.

As the Treasury Department has noted previously, the combination of three key features of Fannie Mae's and Freddie Mac's retained mortgage portfolios warrant the attention of policymakers: (1) the size of the retained mortgage portfolios of Fannie Mae and Freddie Mac – $1.4 trillion as of year-end 2007; (2) the lack of effective market discipline; and (3) the interconnectivity between the GSEs' mortgage investment activities and the other key players in our nation's financial system, both insured depository institutions and derivative counterparties. The combination of these three factors causes the GSEs to present the potential for systemic risk to our financial system and the global economy.

The idea that the GSEs have unique characteristics that could create tensions or potential problems is not an ideological or partisan view. Policymakers have been struggling with the inherent tension and the potential problems posed by the GSEs for decades. In fact, a Treasury Department official stated in testimony a few years ago, "[a]s the GSEs continue to grow and to play an increasingly central role in the capital markets, issues of potential systemic risk and market competition become more relevant." That statement was not from a member of the Bush Administration Treasury Department, but rather from testimony delivered in March of 2000 by the then Under Secretary Gensler of the Clinton Administration Treasury Department.

As we further consider authorities of the new GSE regulator, to address the long-run issues posed by their retained mortgage portfolios, the new housing GSE regulatory agency must be provided specific review authority over the retained mortgage portfolios of Fannie Mae and Freddie Mac. Such authority must establish a clear and transparent process based on guidance from the Congress on how the new regulatory agency will evaluate the retained mortgage portfolios in terms of risk and consistency with mission. While the broader risk issues related to the FHLBanks are less than those that are present with Fannie Mae and Freddie Mac, a review of the investment portfolios of the FHLBanks for mission consistency also would be appropriate.

Conclusion

In conclusion, we at the Treasury Department remain convinced that a new regulatory structure for the housing GSEs is essential if these entities are to continue to perform their public mission successfully. We look forward to continuing to work with you on this important issue. Thank you.

Statement of
The Honorable James B. Lockhart III, Director
Office of Federal Housing Enterprise Oversight
On
"Reforming the Regulation of the Government Sponsored Enterprises"
Before the Senate Banking, Housing and Urban Affairs Committee
February 7, 2008

Introduction

Chairman Dodd, Ranking Minority Member Shelby, and Members of the Committee, thank you for the opportunity to testify on the critical need to reform and restructure the housing Government Sponsored Enterprises' (GSE) regulatory regime. The views that I will be expressing today are OFHEO's and do not necessarily represent those of the President or the Secretary of Housing and Urban Development. However, I can tell you the Secretaries of HUD and Treasury, President Bush and Fannie Mae and Freddie Mac support GSE reform.

These are unprecedented times for the housing GSEs – Fannie Mae, Freddie Mac, and the twelve Federal Home Loan Banks (FHLBanks). Their business expanded rapidly in 2007 with their market share rising to record levels in the fourth quarter of 2007. The GSEs have become the dominant funding mechanism for the entire mortgage system in these troubling times. They are fulfilling their missions of providing liquidity, stability, and affordability to the mortgage markets. In doing so, they have been reducing risks in the market, but concentrating mortgage risks on themselves. Fannie Mae and Freddie Mac support their missions by guaranteeing and issuing mortgage backed securities (MBS), which represents approximately 70 percent of their business in 2007. Their other business activity is buying mortgages and MBS for their retained mortgage portfolios.

The risks are beginning to take their toll. Public disclosures indicate that Freddie Mac will report annual losses for the first time in its history and Fannie Mae for the first time in 22 years. Their missions, as well as Congressional and many other pressures, are demanding that they do more and take on more risks in areas new to them – subprime and jumbo mortgages. As the safety and soundness regulator of Fannie Mae and Freddie Mac, I have to tell you that expansion of their activities would be imprudent unless the regulator has significantly more powers and more flexibility to use those powers. Given the tremendous stresses on the mortgage markets, the American people cannot afford to have Fannie Mae, Freddie Mac, or the 12 FHLBanks incapable of serving their mission.

During 2007, the housing GSEs debt and guaranteed MBS outstanding grew $870 billion or 16 percent to $6.3 trillion. It is very hard for anyone to put trillions into perspective, but probably the easiest comparison is to the public debt of the United States, as you can see from the chart (1). The left-hand column is the public debt of the United States. It is $5.1 trillion, of which about $700 billion is owned by the Federal Reserve, so there is only about $4.4 trillion in public hands. The total of Fannie Mae's and Freddie Mac's debt and guaranteed MBS, their credit owned by the public, is $5.1 trillion. If you add on top of that the rapidly growing FHLBanks' debt of about $1.2 trillion, you get to that $6.3 trillion of housing GSE debt and securities.

Market Conditions

As has been widely reported, housing market conditions in many parts of the country are quite weak. Virtually all measures of the health of the market have deteriorated very sharply over the last two years, with particularly sharp declines over the latest few quarters.

Home prices are falling in many parts of the country. OFHEO's national purchase-only index fell 0.3 percent on a seasonally adjusted basis in the third quarter, but other indices show much larger drops. Of course, prices are declining at a much quicker pace in many areas such as California and Florida, which had the greatest price run-ups during the boom. Fannie Mae and Freddie Mac are using 4 to 5 percent house price decreases in their 2008 projections, but others are predicting more severe outcomes.

These price declines are closely associated with increases in delinquencies and foreclosure rates. In virtually every state, property foreclosure rates have skyrocketed over the latest year, as have loan delinquency rates. For the third quarter, the Mortgage Bankers Association reported that the overall loan delinquency rate of 5.6 percent was at its highest point since 1986.

Builder confidence and housing starts are at extremely low levels, as inventories of unsold properties have risen. The latest existing home sales data from the National Association of Realtors indicate that, at the current pace, there is approximately 9.6

months worth of supply on the market today, a level well above the six month benchmark for a so-called "balanced" market. With inventory overhang also quite high for new homes, the rate of housing starts has plummeted. In the fourth quarter, the seasonally-adjusted annual rate of housing starts was 44 percent below its rate from the same quarter, two years ago.

The Enterprises' Response

What have the Enterprises been doing given these challenging market conditions? (Chart 2) They have been fulfilling their mission of providing stability and liquidity to the secondary conforming mortgage market. That has been very critical since early August. They have been securitizing almost a hundred billion dollars a month in mortgages as you can see in blue. The green, which is their mortgage portfolios, has not grown because of their internal control and other operational problems and the related OFHEO imposed limits with respect to capital and portfolios. Given the market conditions and their progress, OFHEO loosened the portfolio limits in September of 2007. Despite that added flexibility, the Enterprises have not increased their portfolios. With accompanying capital they could increase their combined portfolios by over $100 billion for the next 6 months without violating the new limits.

As OFHEO directed, the Enterprises adopted the bank interagency guidances on non-traditional mortgages and subprime mortgages. The guidances were implemented in September last year. The guidances are not only for all mortgages that the Enterprises directly hold and guarantee, but also the underlying mortgages in private label securities

(PLS) that they acquire. At the same time we gave portfolio cap flexibility, they agreed to enhance their programs to support the refinancing of subprime into less risky mortgages.

The Enterprises' Conditions

Status and Regulatory Action. When I arrived at OFHEO in May of 2006, we were in the process of finalizing a report on the past misadventures and misdeeds at Fannie Mae, which led to a consent agreement listing 81 areas for correction. One element of the agreement was to freeze the growth of their portfolios and another was a renewal of a requirement that they keep capital levels 30 percent higher than the minimum required by law because of their operational, accounting, systems, internal controls and risk management problems. Thus, the effective capital requirement is 3.25 percent of assets rather than the 2.5 percent required in OFHEO's statute. Both are low compared to other financial institutions.

Freddie Mac had earlier agreed to a consent agreement and the 30 percent extra capital requirement. In July of 2006, they voluntarily agreed to restrict the growth of their portfolio as well. In retrospect, those agreements and, especially, the growth restrictions and the capital requirements, were extremely important in reducing the credit losses at Fannie Mae and Freddie Mac and preventing major disruptions of the conforming loan market system.

I am pleased to report that both Enterprises have made major progress on these operational remediation efforts, which required billions of dollars and many thousands of consultants, but significant issues remain.

In OFHEO's 2007 Annual Report to Congress, both Enterprises were rated as having "significant supervisory concerns." They both published third quarter financials for the first time in over three years. The accomplishment was somewhat dampened by the $3.5 billion of losses that they reported for the third quarter. They have both stated that they expect to produce timely financials at the end of this month for 2007 results. Unfortunately, they expect to report significant losses for the fourth quarter.

Market Share. In 2006, Fannie Mae and Freddie Mac were losing market share to Wall Street private label MBS (PLS). There is a certain irony that one of the ways they prevented their market share from falling even farther was that they became the biggest buyers of the AAA tranches subprime and Alt-A of these PLS. The Enterprises' earlier problems, OFHEO's constraints, and the loose underwriting standards in the market made it hard for them to compete. Some observers even suggested that, due to shrinking of market share, their support of, and therefore their risk to, the mortgage market were no longer relevant.

In the last half of 2007, the PLS world shrunk to minimal levels as a result of a long list of well reported problems (Chart 3). As a result, even with the OFHEO constraints, Fannie Mae and Freddie Mac mortgage purchases as a share of new originations grew to unforeseen levels, rising from less than 38 percent in 2006 to over 60 percent in the third quarter of 2007. The just reported fourth quarter results of 75.6 percent are double 2006's market share. If you add in the net increase in outstanding FHLBank advances, especially in the third quarter, the combined market share of the housing GSEs may be 90 percent.

Credit Risk. Another related change over the period was the growth of credit risk. Operational risk and to a lesser extent market risk had been the key focuses of the Enterprises and they still are extremely important with the volatility of the markets and heavy reliance on models for market and credit risk pricing. I remember listing credit risk concerns in an early presentation I did to one of their Boards. Some members were mystified that I thought it was an issue given their track record. I am afraid that was a sign of the times.

The Enterprises were then reporting credit losses of 1 to 2 basis points, a third of normal levels and now they are approaching double normal levels and climbing. Some of this growth in losses was because they lowered underwriting standards in late 2005, 2006, and the first half of 2007 by buying more non-traditional mortgages to retain market share and compete in the affordable market. They also have very large counterparty risks including seller/servicers, mortgage insurers, bond insurers and derivative issuers.

Basis points sound small, but they become important when you are leveraged the way Fannie Mae and Freddie Mac are, as seen in Chart 4. This graph shows the gross mortgage exposure of the Enterprises' combined guaranteed MBS and mortgage portfolios relative to their capital, measured two ways. The statutory core capital is shareholder's equity excluding Accumulated Other Comprehensive Income (AOCI), which is primarily marking their Available for Sale portfolios to market. As AOCI is a large negative number, core capital is significantly higher than shareholder's equity, especially at Freddie Mac, which also has losses on some old closed hedges in AOCI. Their leverage increased in the first nine months of 2007, with Fannie Mae's at 66 times core capital and Freddie Mac's at 58 times core capital as of September 30th. Fair value capital is calculated by marking all on- and off-balance assets and liabilities to market. Measured this way, each Enterprise's leverage increased dramatically in the first nine months of 2007, exceeding 80 times their fair value of equity as of September 30th. Or if you look at it the other way around, there is only 1.2 percent of equity backing their mortgage exposure.

For the first three quarters of 2007, they have each lost \$8 to \$9 billion in fair value of equity. Their combined fair value equity at the end of the third quarter was \$58 billion compared to \$5.1 trillion in mortgage exposure. I should hasten to add in the fourth quarter they raised almost \$14 billion in equity in the form of perpetual preferred stock and cut their dividends as well. That additional capital is critical as both CEOs recently said at a Wall Street conference, they are going to have very tough fourth quarters and 2008s.

In short, deterioration in the housing and credit markets, along with substantial declines in interest rates that negatively affected the market value of their derivatives, will result in both Enterprises reporting net GAAP losses for the year. Very importantly, they did fulfill their critical mission of providing liquidity and stability to the conforming loan mortgage market. In doing so, however, the systemic risk of the secondary mortgage market has become more concentrated in the housing GSEs, especially Fannie Mae and Freddie Mac.

Conforming Loan Limit Increase

Now, I will turn to the temporary increase in the Conforming Loan Limit (CLL) as proposed in the Economic Stimulus package. OFHEO believes any increase in the CLL should be coupled with quick enactment of comprehensive GSE reform. The CLL provision in the stimulus package would increase the Enterprises risks by allowing them to enter the "jumbo" loan market. It would increase the maximum size loan those GSEs could purchase or guarantee from $417,000, to the lower of 125 percent of median area prices or $730,000, for mortgages originated between July 1, 2007 and December 31, 2008. This change should help lower interest rates on some jumbo mortgages, but other potential implications deserve attention.

Jumbo loans would present new risks to the already challenged GSEs. The prepayment and credit risks are different than those of conforming loans. The provision also pushes the GSEs to increase their geographic concentration in some of the riskiest real estate markets. Roughly half of all jumbos are in California. Underwriting them successfully will require new models and systems to ensure safe and sound implementation. Capital also would present challenges even if all newly conforming mortgages are securitized. A $600,000 loan requires as much capital as three $200,000 loans.

Tying the new limits to FHA limits will likely result in a large number of different loan limits across the country, requiring additional operational challenges. That could delay lender participation, especially for non-FHA lenders. Like the GSEs, they may have to reprogram and adjust their guidelines and agreements to account for a large number of different local loan limits.. All that being said, OFHEO promises to work closely with Fannie Mae and Freddie Mac to ensure that an increase is implemented quickly, and as safely and soundly as possible.

Critical Need for GSE Reform

The key question is whether Fannie Mae and Freddie Mac will be able to continue to support the conforming mortgage market in a safe and sound manner while assuming additional responsibilities in the subprime and jumbo markets.

My answer as the safety and soundness regulator is yes, but only if Congress passes comprehensive GSE reform.

Why is GSE reform so critical now?

- As never before the Enterprises and FHLBanks have become the backbone of the mortgage market in very troubling times. They were created for this kind of market. They need to provide liquidity to the mortgage market today and in the future.
- We need to maintain confidence in the GSEs and their capital position, especially with the holders of their $6.3 trillion of securities, both foreign and domestic.
- We need to start to rebuild confidence in the housing and mortgage markets. The conforming loan market continues to perform well, but Fannie Mae and Freddie Mac are now being asked to expand their missions by providing liquidity in the subprime world and temporarily in the jumbo market. We have encouraged the Enterprises to increase subprime rescue mortgages, but we must ensure that they have the capital, models and systems to take on the additional subprime and jumbo risks.
- Their large losses, growing credit and market risks, model risks, sheer size and market share requires a stronger regulatory framework to reduce the potential for risks to the financial and mortgage markets.

To achieve those goals we need a stronger, single and unified regulator for the housing GSEs. That regulator needs to have all the powers of the bank regulators and more given the Enterprises size, systemic importance, and GSE status. Capital is king in this market. The regulator also has to ensure that they stay focused on their mission of supporting the housing markets, especially affordable housing.

When normal financial institutions get into trouble, the rating agencies downgrade them and the cost of their debt goes up. Fear of such a negative sequence incents them to restrain their risks. However, even during the periods when the Enterprises could not put out financial statements for several years, they were rated AAA. In fact, their debt sells better than AAA paper. Without debt market discipline, there is limited offset to shareholders' pressures to grow. When present, debt market discipline helps to ensure that growth is safe. We need a stronger regulator as a substitute for that lack of debt market discipline.

Elements of GSE Reform

Let me now speak briefly to components of comprehensive GSE reform. First, as in the House-passed bill, GSE reform should create a single, unified and independent GSE regulator. This combination would strengthen the GSE regulators, OFHEO and the Federal Housing Finance Board (FHFB). Comprehensive GSE reform would also transfer HUD's mission and new product authority to the new regulator. Comptroller General David Walker testified before this Committee in April 2005: "...A single housing GSE regulator could be more independent, objective, efficient and effective than separate regulatory bodies and could be more prominent than either one. We believe that valuable synergies could be achieved and expertise in evaluating GSE risk management could be shared more easily within one agency."

Unlike any other financial regulator, OFHEO is lacking mission and new product authority. That can lead to tensions as there is often a trade-off between mission and safety and soundness. Mission can push you too far to take too many risks and safety and soundness can pull you back. What needs to be done is that significant new products and programs must be evaluated on a balanced basis at one time through both mission and safety and soundness lenses, before they are launched.

There is a strong consensus, including from the Enterprises, that the new regulator needs bank regulator-like powers. Bank regulators have receivership authority which can provide more market discipline and certainty in uncertain markets. We only have conservatorship authority. Another component is stronger independence and that means independent litigation and budget authority. We are very actively engaged in litigation in the federal courts related to Fannie Mae's past problems and reliance on the Justice Department makes for a cumbersome process.

We have this strange budget mixture where we are funded by Freddie Mac and Fannie Mae, but yet we are appropriated by Congress as if we were funded by taxpayers. In only two of our fifteen years has OFHEO known how much money we had to spend when the year started. Uncertain funding levels and the resulting under-staffing is not the way to run a regulator.

Most critically, OFHEO needs the flexibility to adjust capital requirements. The statutory minimum capital requirements for on-balance sheet assets are too low at two and half percent. While I do not know if the thirty percent increase is the right level, I do know we need more flexibility to regulate minimum capital. I also know our risk-based capital

(RBC) requirement is just not working, as it has yet to capture the risks we are currently observing. The problem was that RBC parameters were specified in law and this does not really give OFHEO the flexibility bank regulators have, which is needed to create a modern economic capital framework.

Finally, we need to ensure their focus on mission, not only mortgage market liquidity and stability, but also affordable housing. Only 30 percent of their mortgage assets in their combined retained portfolios represent funding for units that count toward HUD's affordable housing goals beyond that provided by securitization. To continue to provide stability and liquidity, market, credit and operational risks of the retained mortgage portfolios must be understood and managed. Half of their portfolios are in their own MBS. As that represents 17 percent of all their outstanding MBS, it seems excessive for liquidity purposes. The rest of their portfolios are split between mostly AAA subprime and Alt-A PLS mortgage securities and whole mortgage loans. What the new regulator needs is the ability to produce a regulation that considers the missions and risks of the Enterprises. That would give it the tools to more effectively get the job done well to ensure the Enterprises' long-term safety and soundness and mission achievement.

Changes that Would Enhance GSE Reform Legislation

I hope that I have conveyed to the Committee the market conditions and the status of the Enterprises that emphasize the urgency of acting upon GSE regulatory reform. It is our highest priority. OFHEO is fully committed to working with you to address any questions you may have and to provide our insights on approaches that you set forth for consideration.

Over the years, there have been many proposed GSE reform bills. I believe that the House-passed measure, H.R. 1427 is a good starting point. It is a strong, balanced and bi-partisan bill that addresses many of the key issues. I would add a few topics that would enhance a final GSE reform bill:

- Requiring an immediate effective date for legislation. Key authorities are now needed by OFHEO to address current safety and soundness issues such as the potential increase in the CLL. Immediate enactment will add to confidence in the financial markets of continuity and certainty in regulatory oversight.

- Clear guidance on portfolio limits along the lines of the House legislation but which adds consideration not only of risks to the Enterprises but to the housing markets and individuals as well.

- Assuring the new agency has discretion with respect to the critical capital levels for Fannie Mae and Freddie Mac as it does for the FHLBanks.

- Allowing the regulator to refine the definition of core capital with notice and comment rulemaking, in light of changing accounting standards.

- Providing receivership authority with regulator discretion to select the best method of managing the receivership.

Conclusion

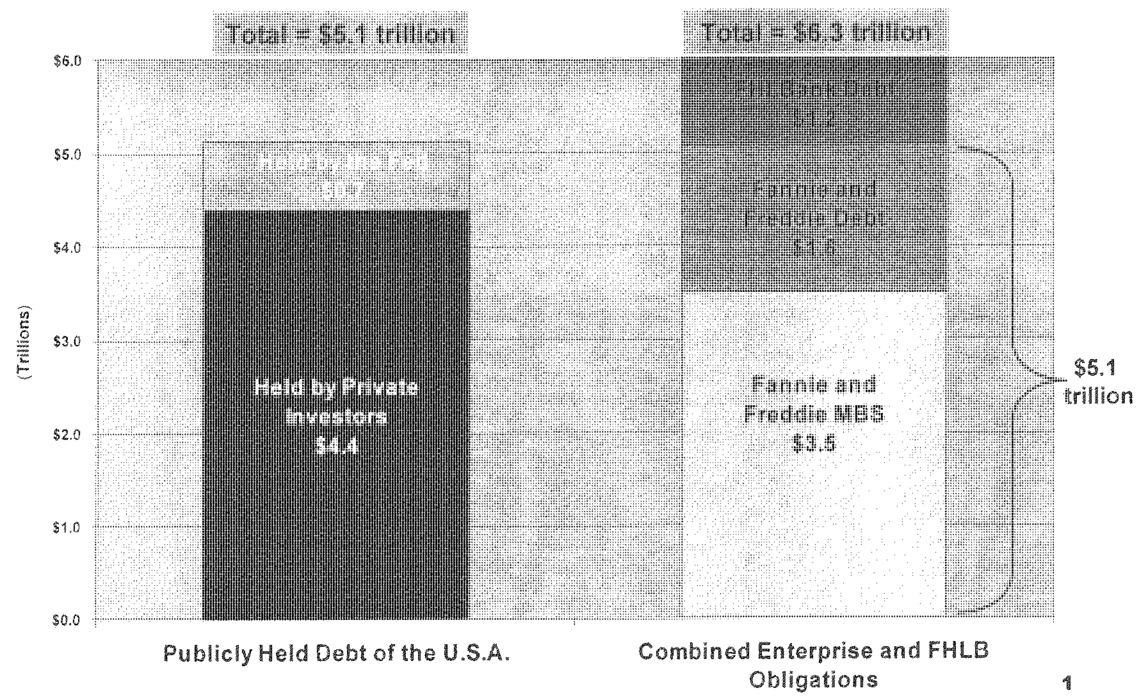
Housing is a key component to the U.S. economy, and it currently is a very troubled component. We need quick actions that will also yield long term positive effects. The GSEs have been very helpful over the last six months providing stability and liquidity to the conforming market segment, but they are stretched. We need to shore them up going forward to help restore confidence in the mortgage market. Fannie Mae and Freddie Mac face growing pressures to expand their mission and risk levels, especially into the jumbo market. We need to create a much stronger, unified regulator to support the U.S. housing finance system. I look forward to working with you Chairman Dodd, Senator Shelby and all members of this Committee towards achieving a stronger housing finance system with an empowered, unified regulator. GSE reform is critically needed now.

Thank you.

The Housing GSEs are Huge

OFHEO

December 2007

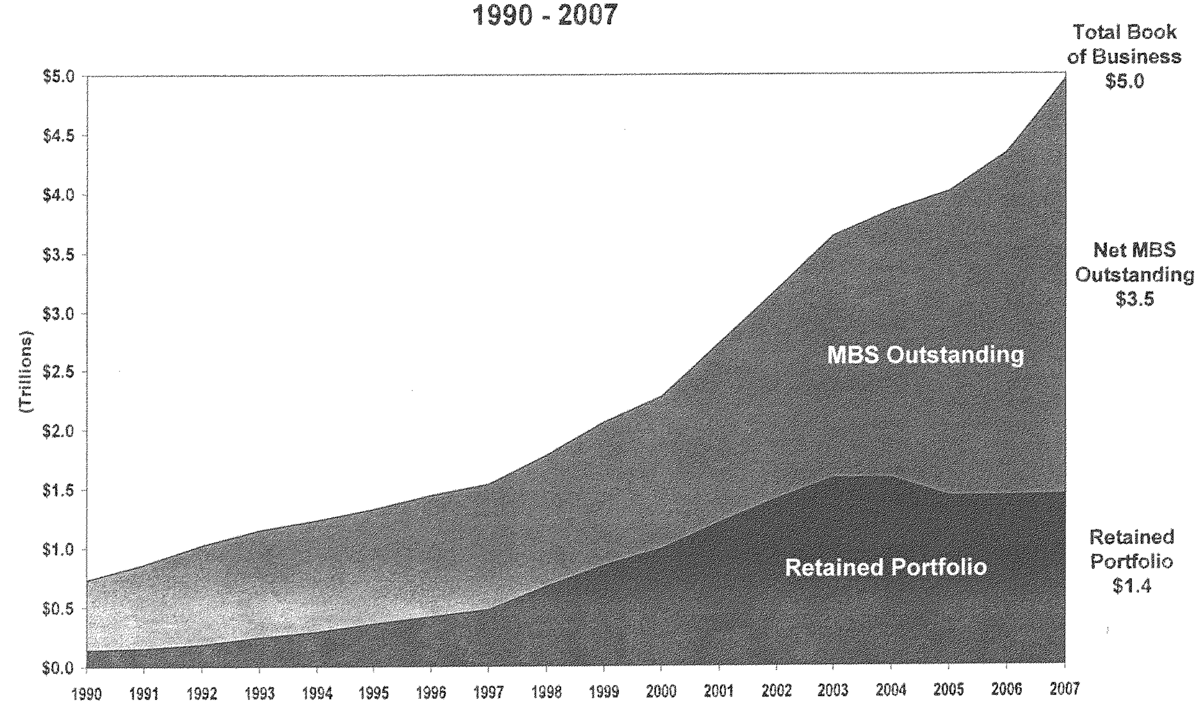


1

Business Growth is Accelerating

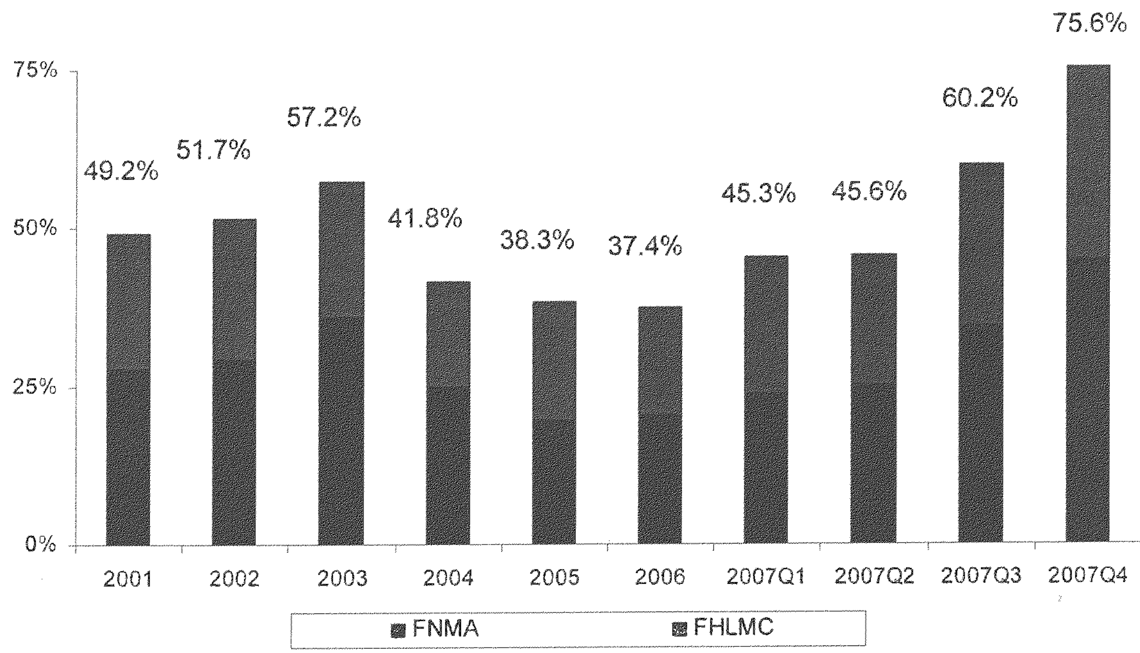
OFHEO

1990 - 2007



Dramatic Increase in Share of Mortgage Originations

2001 – 2007

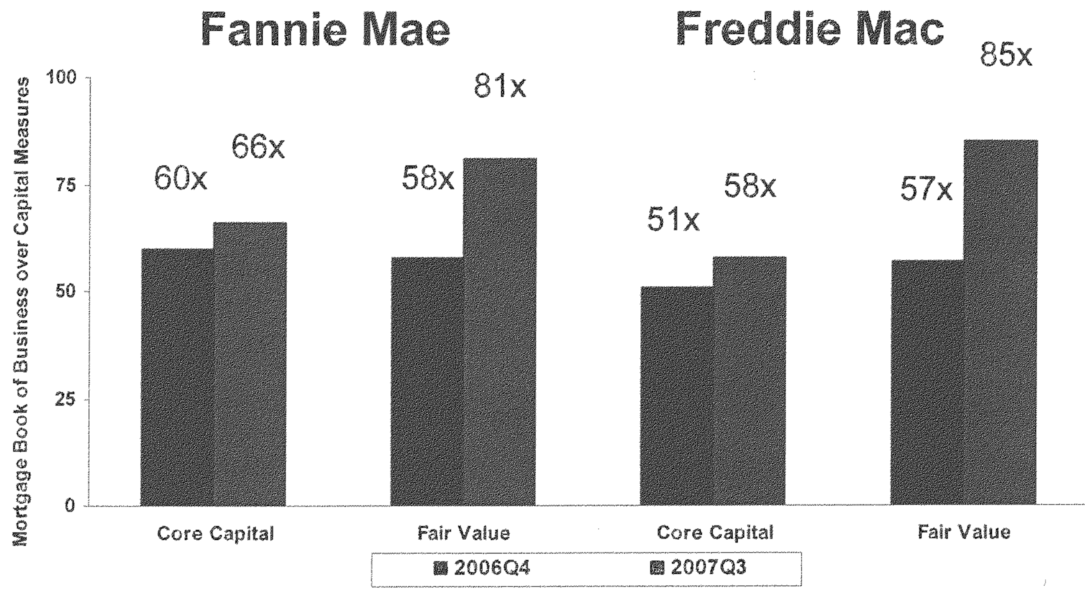


Source: Inside Mortgage Finance

Very High Mortgage Credit Leverage

OFHEO

12/31/2006 & 9/30/2007



PREPARED TESTIMONY OF RONALD A. ROSENFELD
CHAIRMAN, FEDERAL HOUSING FINANCE BOARD
BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
FEBRUARY 7, 2008

Thank you, Chairman Dodd, Ranking Member Shelby, and distinguished members of the committee. I appreciate the opportunity to present a statement to you about the importance of reform of the government sponsored enterprises. The views that I will be expressing today are mine and do not necessarily represent the views of my colleagues on the board.

It has been more than two years since I appeared before this committee, and a great deal has happened during that time. So, before I offer comments on government-sponsored enterprise (GSE) reform, I would like to provide you, the members of this committee, with a brief update on the financial performance and condition of the Federal Home Loan Banks (FHLBanks) and highlight the actions the Federal Housing Finance Board (Finance Board) has taken to enhance the safety and soundness of the System. I am confident that these steps benefit the public who are served by the housing finance and community development activities of the FHLBanks, as well as the FHLBanks and their shareholder/member institutions.

Background

The Finance Board's primary duty is to ensure that the 12 FHLBanks and their joint office, the Office of Finance, operate in a financially safe and sound manner. In addition, the Finance Board ensures that the FHLBanks carry out their housing finance and community lending mission, remain adequately capitalized, and remain able to raise funds in the capital markets. The Federal Home Loan Bank Act requires the Finance Board to examine each FHLBank at least annually. As an independent non-appropriated agency, the Finance Board sets its own budget consistent with fulfilling its duties and responsibilities. The Finance Board assesses the FHLBanks for the costs of its operations.

The 12 FHLBanks and the Office of Finance serve the public by promoting the availability of housing finance through more than 8, 079 member institutions. The FHLBanks principally provide a readily available, low-cost source of secured funding for their members and, to a lesser extent, a secondary market facility for home mortgages originated or acquired by their members. The FHLBanks are cooperatives; members own the stock of each FHLBank, and the members receive dividends on their investment. Insured banks, thrifts, credit unions, and insurance companies that are engaged in housing finance can apply for membership. Members purchase capital stock from the FHLBank as a condition of membership and also to capitalize any loans, called advances, they obtain from the FHLBank. Only a member institution can acquire an FHLBank's capital stock, and each FHLBanks is separately capitalized by its members.

The FHLBanks play a unique role in housing finance. They make advances, which are collateralized loans, to their members and eligible housing associates (principally state housing finance agencies). The advances are secured by mortgages and other eligible collateral pledged by members, their affiliates, and housing associates. Advances generally support mortgage originations, provide term funding for portfolio lending, and may be used to provide funds to any member "community financial institution" (an FDIC-insured institution with assets of $625 million or less) for loans to small business, small farms, and small agribusiness. This flexibility allows these advances to support diverse housing markets, including those focused on low- and moderate-income households.

FHLBank advances can provide funding to smaller lenders that otherwise have limited access to funding sources. Smaller community lenders often lack access to funding alternatives available to larger financial entities, including repurchase agreements, commercial paper, and large deposits. FHLBank advances offer these lenders access to competitively-priced wholesale funding.

FHLBank advances also offer larger member institutions a stable, competitively-priced source of funding. The FHLBanks have provided much needed liquidity and stability to financial markets over the past six months. Between June 30, 2007 and January 16, 2008, FHLBank advances increased from $641 billion to $877 billion. Much of the increase went to larger member institutions that found their access to alternative funding diminished by the turmoil in housing and financial markets. While the FHLBanks provide an unparalleled source of non-deposit funds for medium- and small-size members, the recent crisis has shown the invaluable help the FHLBanks can provide in supplying liquidity to larger members. Had the FHLBanks not been ready to provide credit to some very large members, the current liquidity squeeze in housing and financial markets would likely have been worse.

In 1989, Congress expanded the FHLBanks' public policy mission by establishing the Affordable Housing Program (AHP) and the Community

Investment Program (CIP). The FHLBanks provide funding to support affordable housing and community and economic development activities of their members through the AHP and CIP. The Finance Board examines and evaluates the FHLBanks' programs using specialist examiners.

Finance Board Operations

The Finance Board's fiscal year 2008 budget is $38.7 million, which represents an increase of $2.9 million compared with the agency's FY2007 budget of $35.8 million. Approximately 90 percent of this increase will expand the resources allocated to the examination and supervision of the 12 FHLBanks. Of the overall budget, $30.8 million, or about 80 percent, is allocated to the agency's safety and soundness supervisory program, and $7.9 million is allocated to the agency's supervision of the FHLBanks' affordable housing and community investment programs. This year's budget allows the agency's Office of Supervision to conduct annual examinations, monitor the FHLBanks' progress in addressing supervisory findings, evaluate FHLBank applications and requests, and prepare supervisory guidance and regulations. In addition, much of the work of the Finance Board's other offices, such as the Office of General Counsel and the Office of Management, supports, either directly or indirectly, the activities of the Office of Supervision through legal analysis; regulatory interpretations; and information technology, administrative, and organizational support. The Finance Board is a careful steward of the funds we assess the FHLBanks. As the data show, our expenditures are for activities that support the Finance Board's primary statutory duty – ensuring the safety and soundness of the FHLBanks.

Two overarching principles guide the supervisory activities of the Finance Board – one is the regulatory independence of the agency and the other is the Finance Board's expectation that the FHLBanks operate consistent with high standards of governance and risk management. By regulatory independence I mean that the Finance Board is an arms-length regulator. While we have interests in common with the System – the desire for strong earnings, strong capital, fulfillment of mission, and others – our responsibilities are nonetheless those of a safety and soundness and mission regulator. The Finance Board strives for excellence, fairness, and consistency in carrying out its responsibilities.

With regard to the second principle, we expect the directors and management of the FHLBanks to adhere to the highest standards of ethics, corporate governance, accounting, and risk management. As GSEs, the FHLBanks enjoy a special privilege in the capital markets. Consistent with that privilege, we also expect the FHLBanks, as government-sponsored enterprises, to maintain low risk profiles and to prudently manage the credit, market, and operational risks to which they are exposed. The FHLBank System's consolidated obligations, for which the FHLBanks are jointly and severally liable, further underscores the need for each individual FHLBank to operate prudently and with high standards.

Let me next share with you some observations. They are observations drawn from my tenure as chairman of the Finance Board and they underpin the regulatory and supervisory operations of the Finance Board. The environment in which the FHLBanks operate has changed significantly in the past five years. There has been further consolidation in the financial services industry, increased use of derivatives to hedge mortgage activity, and changes in accounting, including adoption of new standards for accounting for derivatives. Those changes brought about increased risks and challenges to the business of the FHLBanks and contributed to increased earnings volatility.

In some instances, the FHLBanks did not respond quickly enough to keep pace with the changing environment. Some of the FHLBanks did not embrace and implement governance and risk management tools appropriate for the size and sophistication of their evolving business. A combination of inadequate skills, poor judgment, and control deficiencies contributed to problems at those FHLBanks. The problems at the Chicago and Seattle FHLBanks were such that the Finance Board initiated formal enforcement actions against them in 2004; the rapid growth in their mortgage programs combined with risk management shortcomings contributed to an increased risk profile and declining and more volatile earnings.

At the same time, the Finance Board has addressed shortcomings in staffing and examination resources that had existed for some time. For example, in 2002, the agency's Office of Supervision had just 13 staff members, including nine bank examiners and a mortgage specialist. That staff carried out both safety and soundness and AHP examinations. Risk modeling was rudimentary, costly, and time intensive. Today, we have 100 people in our Office of Supervision, including 42 examiners and mortgage specialists, of which 34 are responsible for safety and soundness examinations and eight are responsible for AHP and CIP examinations. In addition to the examiners and mortgage specialists, other Office of Supervision personnel participate directly in examinations. Financial analysts review the FHLBanks' earnings and condition data and prepare an assessment for each examination of the FHLBank's financial condition and performance. Financial economists monitor and evaluate each of the FHLBank's risk modeling processes and meet with the FHLBanks' quantitative risk modeling staff during examinations. Accountants review the financial statements of the individual FHLBanks and, most critically, are responsible for reviewing the FHLBank System's Combined Financial Reports prepared by the FHLBanks' joint office, the Office of Finance. Our technology has been upgraded, our data collection is more comprehensive, and our supervisory data bases have been integrated. Our off-site risk monitoring and modeling capabilities have been enhanced so that we are now better able to model and monitor the FHLBanks' risks, particularly the interest-rate risk in mortgage portfolios.

The FHLBanks and the Finance Board have undergone significant changes and faced serious challenges in the last few years. We have each learned some important lessons and acted on those lessons. The FHLBanks learned lessons in governance, record keeping and financial disclosure, and internal controls. Risk modeling has improved at the FHLBanks as has the comprehensiveness of their risk management. The Finance Board learned the benefits and need for early and resolute action when problems emerge. The Finance Board has also enhanced its supervisory program through new or revised regulations, supervisory guidance, a new examination rating system, and updated examiner guidance and procedures.

Condition and Performance of the Banks

At December 31, 2007, the combined assets of the 12 FHLBanks were $1.278 trillion, up from $1.021 trillion at the end of 2006. The majority of this increase in assets reflects advances that were extended to member institutions, particularly larger member institutions, after the onset of the crisis in the subprime mortgage market. The FHLBanks have provided substantial liquidity to domestic capital markets.

Advances are the largest asset class constituting 68 percent of combined FHLBank assets. Advances of $875 billion are 36.6 percent higher now than at the end of 2006. The distribution of advances among members reflects, in part, the concentration of assets in the financial services industry. The top 10 holders of advances account for 37.6 percent of the System total of advances, up from 35.6 percent at the end of 2006. Further, reflecting the increased importance of large member borrowing, the top 10 borrowers account for 43 percent of the net increase in advances in 2007. I expect Finance Board examiners to closely monitor advance concentrations at the FHLBanks to ensure that the FHLBanks do not become too reliant on any single customer or a relatively few large customers.

Members must capitalize their advances borrowings by buying FHLBank capital stock when taking out an advance. Capital purchase requirements vary by FHLBank, but normally the requirements range from 4 to 6 percent of the advance. Members also must collateralize their advances. Most common forms of collateral are residential mortgages and securities (including Treasury securities, agency securities, and mortgage-backed securities). The amount of an advance is discounted relative to the collateral. The "haircut" is generally less for securities than for mortgages and less for mortgages than for less liquid types of collateral. Haircuts typically range from as little as 3 percent of market value (e.g., Treasury securities) to approximately 20 percent or more of market value (e.g., unpaid principal balance of a mortgage) to 50 percent or more for less liquid types of collateral (e.g., second mortgages or home equity lines of credit). Each FHLBank has the right to demand additional collateral from a borrower or to refuse to make an advance to a member that fails to satisfy the FHLBank's underwriting criteria. We review FHLBank collateral policies, practices, controls, and audit reports during our annual examinations. FHLBanks must also have "responsible lending" policies concerning subprime and non-traditional loans as collateral and to avoid acceptance of "predatory loans" as collateral.

Mortgage loans purchased from members have declined over the past three years and continue to fall. After reaching a peak of almost $116 billion in June 2004, mortgage loans have been trending downward. This downtrend reflects general mortgage market conditions that are unfavorable toward the acquisition and holding of fixed-rate conforming mortgages as well as strategic decisions by several FHLBanks to de-emphasize the holding of mortgage loans. Mortgages held by the FHLBanks are $91.6 billion or 7.2 percent of assets, down from $98 billion or 9.6 percent of assets at the end of 2006.

The FHLBanks hold investment portfolios totaling $302 billion or 23.7 percent of assets. At December 31, 2008, these investment portfolios were primarily mortgage-backed securities ($143 billion), prime short-term money-market instruments ($143 billion), and federal agency securities ($13 billion).

In terms of MBS, the FHLBanks own approximately $88 billion of private-label MBS; the remainder is agency MBS. At the time of purchase, all these securities were rated triple-A. The Finance Board is closely monitoring developments in the residential MBS market. As of the end of January, the FHLBanks own one security that has been downgraded from triple-A to double-A. That security is under "negative watch" and 58 triple-A-rated securities are under "negative watch."

The FHLBanks principally fund their operations by issuing consolidated debt obligations for which each FHLBank is jointly and severally liable. The consolidated debt obligations are issued by the Office of Finance. Outstanding consolidated obligations are $1.190 trillion.

The total capital of the FHLBanks is $53.6 billion or 4.19 percent of assets. Total capital comprises all stock issued by the FHLBanks plus retained earnings. Of that total, retained earnings are $3.7 billion or 0.26 percent of assets.

In 2007 the FHLBanks' net income was $2.8 billion compared with $2.6 billion in 2006. The return on assets was 0.26 percent, which is the same as 2005 and 2006. As cooperatives, the FHLBanks can return the benefits of membership to members either through dividends or the pricing of advances. The return on equity that has been less than 6 percent annually for the past five years indicates that a significant portion of the benefits of membership come through favorable pricing.

Regulatory Action

The Chicago Bank continues to operate pursuant to a consent order to cease and desist. The Bank took actions and engaged in business activities that were imprudent. It had a high level of excess stock and was intent on growing its mortgage portfolio. The mortgage portfolio increased to 60 percent of assets and was supported by a commensurate amount of member excess stock. Thus, it was supporting long-term assets with stock that had a six-month call by the members. Safety and soundness issues related to its high level of excess stock intensified, and the Finance Board had to act. On October 10, 2007, the Bank accepted the terms of a consent order to cease and desist.

The order imposes restrictions on the Bank's repurchases and redemptions of its capital stock and its payment of dividends until supervisory concerns have been satisfactorily addressed. The action was necessary to improve the condition and practices of the Bank, stabilize its capital, and provide the Bank an opportunity to address the principal supervisory concerns identified. As reported in the press, the FHLBanks of Dallas and Chicago are discussing a potential merger. Any such merger would need Finance Board approval.

Reform of the GSEs

The Congress and the administration have discussed and debated reform of the GSEs for years. I believe it is now time to act. Together the FHLBanks, Fannie Mae, and Freddie Mac play a vital role in helping to finance homeownership for millions of Americans and stabilizing and strengthening housing and financial markets and the economy at large. Given the size and significance of these institutions, which together have more than $3 trillion in assets, it is imperative that they be supervised and regulated by a single federal regulator and that the regulator have all of the tools necessary to provide effective and thorough oversight.

The federal banking agencies have a full arsenal of supervisory and enforcement tools at their disposal, which allows them to take early and resolute action, if necessary. Those tools include examination, capital, and enforcement authority over the institutions they regulate. A new GSE regulator should, at a minimum, have the same tools possessed by the federal banking agencies.

In particular, a new GSE regulator should have the ability to fund itself through assessment of the GSEs and be outside of the appropriations process; it should have the ability to place a GSE into receivership or conservatorship, it should have the authority to approve new and existing business activities; and it should have the power to set minimum capital levels. The Finance Board already has the authority to assess the FHLBanks to fund its operations. Among the federal financial institution supervisory agencies, only OFHEO relies on appropriated funds. In addition, the Finance Board has the authority, and exercises it, to require an individual FHLBank to have and maintain additional capital, to approve new business activities, and to regulate the composition of the FHLBanks' asset portfolios.

A single unified GSE regulator would provide for a more efficient and effective regulatory body. It would be more efficient in its ability to share examination and supervisory information among examiners and other agency staff. The agency's risk modeling would be enhanced by greater interaction and consultation among the quantitative risk professionals already in place at OFHEO and the Finance Board. Examination and risk management expertise and resources could be shared, as appropriate, particularly in dealing with complex or significant supervisory matters at one of the enterprises or the FHLBanks. Finally, all GSEs should have to meet the same high governance and disclosure standards. At present, all 12 FHLBanks are registered with the Securities and Exchange Commission (SEC) and are subject to its oversight of their financial statements and disclosures.

While I believe consultation and interaction are critical attributes of a single federal regulator for the housing-related GSEs, the differences between the FHLBanks and the enterprises must also be recognized and accommodated through any legislation that would reform GSE supervision. The FHLBanks are member-owned cooperatives. Their corporate structure and their business operations are far different from that of shareholder-owned Fannie Mae and Freddie Mac. These differences exhibit themselves in different capital structures, different board structures, and different orientations towards returns to stockholders and pricing of products to their customers. Also, the essence of the FHLBanks' business is secured lending where most of the collateral is mortgage loans; the FHLBanks do not securitize mortgages and direct mortgage holdings are only 7.2 percent of total assets.

Conclusion

The recent stress in the housing market has taught us that GSEs are vital to supporting the nation's housing needs. In particular, FHLBank advances have provided critical liquidity to members whose alternative sources of funding had dried up. A single regulator would assure homebuyers and market participants that the overseer of the housing GSEs speaks with a single voice, acts with a consistent purpose and is clear, consistent and vigilant. While the housing GSEs can and do operate in a variety of different ways to fulfill their housing finance mission, they have a common heritage, they share many of the same customers, they raise funds from the same sources and the recent environment has shown us that whether they securitize mortgages, own mortgages or take them as collateral, they have common concerns. Simply put, reform of the GSEs makes sense. It will help to promote a healthy and vibrant housing market.

Testimony of Richard F. Syron
Chairman and CEO, Freddie Mac

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
February 7, 2008

Chairman Dodd, Ranking Member Shelby and members of the Committee:

I greatly appreciate the opportunity to appear before the Committee today to discuss key aspects of proposed legislation on regulatory reform of the oversight of Freddie Mac and Fannie Mae (GSEs), and the Federal Home Loan Banks.

The last time I testified before this Committee was in 2005. Things were very different then. In 2005, single-family housing starts set a record; at the end of 2007, they had fallen 50 percent from their peak. House prices adjusted for inflation were growing at the fastest pace recorded in the past century. Today nearly every measure shows significant declines in both real and nominal values. Back then, the spread between jumbo and fixed-rate, conforming mortgages was 20 basis points. Today that spread is in the neighborhood of 100 basis points, a record high. Back then, the global capital markets were flush with liquidity and investment banks were reporting large profits. Now, a number of lenders have gone out of business, others have had serious problems, and we are in a global credit contraction. Since 2005, foreclosures have doubled – a tragedy not only for the families involved but also for the communities in which they live.

This dramatic shift in housing's fortunes has major implications for the broader economy. Instead of a strong housing market moving in tandem with a robust overall economy, as was the case in 2005, many fear that the downturn in housing may drag the broader economy into recession. That is something no one wants to see. Hence, it is a delicate moment for policymakers and market participants alike.

It is against the backdrop of a market in turmoil that we again consider the issue of GSE regulatory reform. As I have testified in the past, my views have been profoundly shaped by my 25 years spent regulating financial institutions. Perhaps the most salient thing I learned was the critical need for maintaining safety and soundness while, at the same time, assuring adequate credit flows, particularly in times of economic distress. Although we are in uncharted waters in terms of the forces driving today's housing finance crisis, these lessons from the past still hold true.

History as Guide

In the early 1990s a credit crunch in New England turned into a severe regional slump that lasted for more than half a decade.[1] I observed this crisis first-hand during my tenure as President of

[1] History of the Eighties, Lessons for the Future: An Examination of the Banking Crisis of the 1980s and Early 1990s, vol.1, part 2, Sectors and Regional Crisis, Ch. 10, Banking Problems in the Northeast, Federal Deposit Insurance Corporation, 1997.

the Federal Reserve Bank of Boston. As I testified in 1991 before the Subcommittee on Domestic Monetary Policy for the Committee on Banking, Finance and Urban Affairs (attached), while many banks were adequately capitalized on a risk-adjusted basis, procyclically-required increases in capital exacerbated the downturn.[2] Ultimately, this led to a "capital crunch" that further curtailed credit availability for all types of real estate lending save one: conforming residential loans.

The conforming mortgage market was protected from the downturn because Freddie Mac and Fannie Mae were doing the job that Congress had assigned them: restoring stability by providing liquidity and responding appropriately to capital markets' trauma, thereby mitigating economic shocks and supporting a recovery.

I did not always have such a sanguine view of Freddie Mac and Fannie Mae. As an economist, I viewed GSE intervention in the housing market as inefficient. One or two credit crises have a way of changing one's thinking, however. In times of financial stress, markets can go to extremes, and the resulting disappearance of liquidity can impose severe costs throughout the economy. The GSEs, it must be acknowledged, do lend support to one of the most vital segments of our economy. Moreover, homeownership has been and will continue to be central to the American dream of homeownership, and strong, vibrant GSEs are a key to making that dream a reality.

Today, the conforming market supported by Freddie Mac and Fannie Mae is the only well-functioning segment of the mortgage market. To be sure, we're experiencing greater losses as house prices decline, but that is not surprising since this is the market we were created to support. That said, long-term fixed-rate conforming mortgages are still widely available and rates are low. Since the market downturn in August, the two GSEs have supplied $466 billion in prime market liquidity, saving conforming market borrowers almost a full percentage point on their mortgages.

In addition to providing needed liquidity, Freddie Mac has taken a leadership role in addressing some of the excesses of subprime lending. Last winter, we were the first to announce that we would restrict our subprime investments in securities backed by short-term adjustable-rate mortgages (ARMs) to those that have been underwritten to a fully-indexed, fully-amortizing level. We also restricted the use of stated income in lieu of more traditional documentation standards and encouraged subprime lenders to escrow borrower funds for taxes and insurance.

Senator Dodd provided early leadership on this issue when he convened the Homeownership Preservation Summit, in which we were pleased to participate. Freddie Mac made a commitment at that time to buy $20 billion in consumer-friendly mortgages that provide better choices for subprime borrowers. Since May 1, 2007, we have bought about $42.5 billion of prime

[2] Richard F. Syron, "Are We Experiencing A Credit Crunch?" *New England Economic Review*, July/August 1991, pp. 3-10.

mortgages that financed borrowers whose credit profiles might have otherwise relegated them to the subprime market. Finally, we have consistently been at the forefront of efforts to help borrowers avoid foreclosure. Freddie Mac and its servicers helped nearly 47,000 borrowers avoid foreclosure and keep their homes in 2007.

These efforts follow a long leadership tradition. Since 2000, Freddie Mac has taken unilateral, voluntary leadership positions to combat predatory lending. These include our bans on single-premium credit life insurance, prepayment penalties greater than three years on subprime loans, and mortgages with mandatory arbitration contracts, and our insistence on regular credit reporting.

I applaud Senator Dodd and the members of this Committee for the careful attention they are giving to the mortgage market crisis. Last week, the Committee heard a variety of ideas about how to cut the number of subprime foreclosures, moderate the decline of house prices, and try to stabilize neighborhoods. The fact that we need to consider these ideas demonstrates the gravity of the present situation.

Finding the Right Balance

As with the New England credit crunch, finding the right balance between capital and liquidity goes to the heart of today's GSE debate. This debate is about how much capital is needed to ensure the continued safety and soundness of the GSEs versus how much should be deployed to protect homeownership gains, stabilize neighborhoods and support our nation's housing industry, a key sector of the economy.

It is not an easy balance to strike, and there are legitimate differences of opinion. GSE oversight must satisfy two potentially opposing objectives, safety and soundness and mission, and difficult tradeoffs sometimes must be made. For example, some want the GSEs to hold more capital – along the lines of the capital ratios that banks are required to meet. At the same time, others want the GSEs to deploy their capital more freely in order to extend the availability of mortgage credit to higher risk borrowers and product segments. But there is another consideration as well: the people that provide the capital in the first place justifiably expect to receive a reasonable return on their investment. Otherwise, the GSEs would lose access to the capital markets and taxpayers would lose an important first line of defense.

As to the question of whether Freddie Mac supports regulatory reform, the answer is "Yes." We have long said that regulatory reform is needed to ensure continued public – and investor – confidence in the GSEs. We just need to ensure that reform strengthens the GSEs and their ability to meet their important housing mission – while keeping investors in the game.

Capital

Without a doubt, appropriate capital is critical to the long-term safety and soundness of any financial institution – the GSEs included. Appropriately capitalized institutions are also critical to the viability of markets, as we are seeing today.

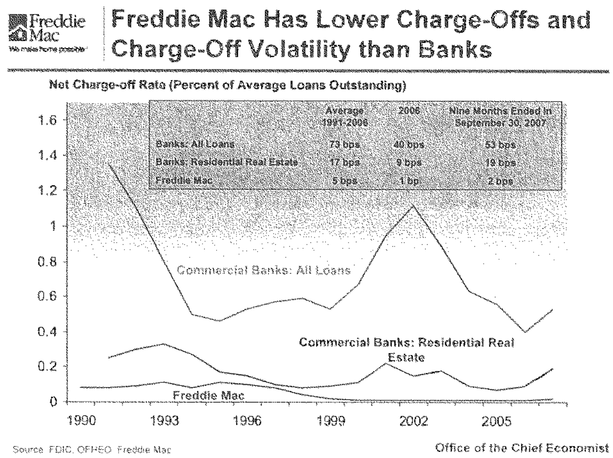
The subprime mortgage crisis has set into motion a destructive cycle in which falling house prices exacerbate credit problems and generate losses for lenders and investors. These losses, in turn, erode the capital at financial institutions. In response, lenders and investors have been forced to shrink their balance sheets and pare back lending, further restricting market liquidity and credit availability. These tighter credit conditions complete the circle, as weakening demand feeds through into lower house prices.

One repercussion of this dangerous spiral has been that many large commercial and investment banks have sought capital infusions to bolster their balance sheets. Freddie Mac has added substantially to our capital position as well. As it stands now, the GSEs are one of the few sources of patient capital to invest in the mortgage market, which is exactly what is needed to see us through this crisis.

In light of these very real challenges, it is imperative that the GSE regulatory framework set the level of capital consistent with the inherent risks of the assets while considering the important mission the GSEs must play, particularly in turbulent times. Freddie Mac currently manages to a 30 percent capital surplus above our minimum requirements. This surplus was established by our regulator four years ago to address heightened operational risk, and I believe it was the right thing to do at the time. Since mortgage credit was abundant (some might say too abundant), the market was not overly affected by the higher levels of GSE capital.

However, permanently higher capital without regard to risk could have a significant market impact, particularly in times of economic strain. This could occur, for example, if the GSEs were required to hold the same level of capital as banks – even though GSE losses are significantly lower. As shown in the chart below, for the first three quarters of 2007, Freddie Mac charge-offs rose to 2 basis points. In contrast, bank residential mortgage charge-offs rose to 19 basis points, and total bank charge-offs rose to 53 basis points. Not only are bank losses higher, but they have risen more over the past year relative to Freddie Mac's. Given the state of the mortgage market, our losses will rise but will likely continue to remain a fraction of banks' losses on residential mortgages.

Testimony of Richard F. Syron
Chairman and CEO, Freddie Mac
Committee on Banking, Housing, and Urban affairs
United States Senate
February 7, 2008



Requiring the GSEs to have the same leverage ratio as banks would make the GSE business model unviable without enormous price increases, which would be problematic on a number of fronts. If required capital levels are raised too high, the return to shareholders could be so diluted that we would not be able to attract the capital needed to provide liquidity to the market.

Risk-based standards should be designed to ensure sufficient capital to support the risks that arise from our business. We would also support a framework that provides the GSE regulator discretion to raise minimum capital standards temporarily based on a finding of increased risk, where the levels return to the earlier level once the circumstances giving rise to the increase have subsided.

These clarifications are needed to ensure that the GSEs remain safe and sound and that we can fulfill the critical market-stabilizing role we were created to play. Finding the right balance on capital is so important to the economic viability of the enterprises, as well as to their ability to meet our mission, that some guidance should be written into the statute to ensure that Congress' intent is clear.

Mission
Under our charters, the GSEs have a three-fold mission to maintain the liquidity, stability and affordability of the conventional conforming market. That last component is very important to us. Despite the present challenges in mortgage markets, families' needs for affordable housing are not going away.

The housing market has just concluded a long period of strong house price growth, which facilitated the extension of mortgage credit to borrowers with weaker credit profiles and limited capacity to repay the loans. In retrospect, there was an unrealistic expectation that unending house price appreciation would compensate for these risks. The entire country is now paying dearly for this shortsightedness – not the least of whom are the families who are at risk of losing their homes and the communities devastated by foreclosures and falling property values.

For this reason, we are very concerned about the efficacy of legislation that imposes more and deeper-targeted housing goals on the GSEs, as well as additional duties and penalties. Excessive mandates can result in an over-extension of mortgage credit to some borrowers with consequences like those we are seeing in the subprime market today. In fact, a disproportionate share of the credit losses come from the loans that qualify for our affordable housing goals; these loans incur losses approximately two times the rate of non-goal qualifying loans. Because there are ebbs and flows in the economy, the goals need to be flexible enough to adapt to changing circumstances.

To address these concerns, key modifications are needed to allow the enterprises the capacity to meet the affordable housing components of our mission in all economic environments. These components cannot be achieved in the abstract – they must be aligned with market and business realities. For example, we would urge that goal levels be closely *tied* to actual market conditions and that the affordable housing fund be *tied* to the profitability of the enterprises. Legislation also should guard against a proliferation of goals, subgoals and overlapping requirements, and provide an enforcement regime that is remedial rather than punitive. Bonus points worked well in the past to encourage the GSEs to enter more challenging markets when it made business and market sense to do so.

Greater flexibility would ensure that the GSEs pass along important charter benefits to targeted families without distorting markets or fueling the origination of mortgages unsustainable in times of economic strain. We look forward to working with this Committee and others in Congress to ensure that the GSEs meet the affordable housing component of our mission in the most efficacious way possible.

Portfolio

Freddie Mac's ability to buy mortgages and hold them in our retained portfolio is an important tool in fulfilling our obligation to help maintain the liquidity, stability and affordability of the mortgage market. Portfolio purchases are especially important when other investors leave the market; our purchases add liquidity to the mortgage market, which helps keep rates low for borrowers. Portfolio purchases also provide the company a diversified source of income relative to securitization alone. This is an important way we build capital needed to withstand inevitable downturns in the housing market like the extraordinary one we are experiencing today.

In our view, an appropriate capital and supervisory regime remains the best way for the regulator to ensure that the risks of our portfolio do not threaten our safety and soundness. If, however, the Committee believes that it is prudent to give the regulator explicit authority to oversee the portfolios, the focus should be on managing the risks the portfolios pose to our financial safety and soundness, and require the regulator to balance that with our broad mission to provide liquidity, stability and affordability in all market environments. As I mentioned before, the portfolio should allow us to offer a reasonable return to shareholders, who are the source of the capital that underlies our stability and protects taxpayers.

Activities

A final area the Committee may want to consider is the need to ensure that any GSE reform legislation preserves our ability to bring innovative initiatives to the marketplace.

Under our charter, Freddie Mac cannot originate mortgages, and, let me assure you that we have no desire to exceed our charter authorities. Under current law, HUD must approve any GSE "new programs." This process is working: we keep HUD apprised of any initiatives that may require approval, and HUD has been vigilant in its review of our initiatives and activities.

If we are to fulfill our charter, however, we must be able to innovate and act nimbly to meet the needs of our customers and the market – as we did last summer when we quickly brought to market our new SafeStep[SM] subprime alternative product. To ensure our continued ability to innovate to meet market needs, we would be concerned about a regulatory regime that is overly rigid and that seems more designed to protect our competitors than to ensure that we can continue to fulfill our mission.

In summary, Freddie Mac supports GSE reform legislation that strikes the appropriate balance between mission and safety and soundness. The present downturn in the housing markets reminds us again of the importance of the GSEs and the need to keep them strong and vibrant. The way to do that is to ensure that capital is tied to risk and that the affordable housing obligations make sense in all economic environments. Providing liquidity, affordability and stability is the mission Congress gave Freddie Mac 38 years ago, and we remain committed to doing our best to fulfill it.

* * * * *

Thank you for the opportunity to appear before the Committee today. I look forward to working with Chairman Dodd, Ranking Member Shelby and the members of this Committee.

New England Economic Review
Jul/Aug 1991
pp. 3 - 10
Richard F. Syron

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Are We Experiencing a Credit Crunch?

Richard F. Syron

President, Federal Reserve Bank of Boston. Statement before the Subcommittee on Domestic Monetary Policy of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, May 8, 1991.

Mr. Chairman and distinguished members of the Subcommittee on Domestic Monetary Policy, I am pleased to appear before you to discuss current questions about the availability of credit. As you are all aware, this has been an issue of particular concern in New England. The lessons learned from our experience during both the credit laxity of the mid 1980s and the ensuing reaction should assist us in avoiding similar credit difficulties in the future.

In the hope of providing some perspective on these problems, I will begin by attempting to define what is commonly called a "credit crunch." I will then describe how developments in the financial and real sectors of the economy led to restricted credit availability, and why the situation has been particularly acute in New England. Finally, I will conclude with the outlook for the future, and caution that while we do not want to return to the credit conditions of the mid 1980s, which often were characterized by excessive credit expansion, we also must make sure that the 1990s do not become a period of excessive credit contraction.

Definition of a Credit Crunch

One particular difficulty with the debate over the credit crunch is that the term is used to describe a variety of credit conditions. Few borrowers believe they should ever be refused credit, and they interpret a denial as evidence of broader credit problems rather than a problem specific to the project for which they seek credit. Few loan officers believe that they ever refuse credit for profitable projects, but the uncertainties surrounding any project and the underlying health of the economy make credit assessments essentially judgmental. The natural gap between optimistic borrowers and skeptical lenders is inherent to the credit process. Even during periods of rapid credit expansion, some

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borrowers will be denied credit that would certainly be granted in a world with complete information and no uncertainties. Thus, anecdotal evidence of credit denials is hardly evidence of a credit crunch.

Perhaps the best definition of a credit crunch can be reached by determining whether current lending patterns conform to standard practices at the same phase of previous business cycles. Clearly, lending behavior must change over the business cycle. Because credit evaluation is so dependent on expectations, the outlook for projects can vary significantly depending on whether lenders expect the economy to contract or expand. If credit conditions during recessions were to be compared to conditions during expansions, all recessions would qualify as credit crunches. Thus, a more useful definition of credit crunch asks whether credit availability is unusually restrictive for the current stage of the business cycle.

Historically, credit crunches have been associated with disintermediation, the loss of bank deposits when higher rates of return on assets were available from outside the banking sector. In the absence of regulation, depository institutions would normally have responded to such a loss of funds by raising the rates they paid on deposits; however, this was prevented in the past by ceilings on interest paid on bank deposits. The extent of bank losses of deposits would vary across institutions, depending on their depositors' sensitivity to return differentials, but most depository institutions responded to periods of disintermediation by tightening credit. As market interest rates dropped, the ceilings on bank deposit rates would become nonbinding and disintermediation and the so-called "credit crunch" would end.

The Current Capital Crunch

Our current credit problems are not the result of a drain of bank deposits, to be ended by lower interest rates. In substantial measure this period of tight credit is the result of a loss of bank capital, rather than a loss of deposits. The shrinking availability of credit from banks thus may be more accurately characterized as a capital crunch rather than a credit crunch.

This capital crunch has been uneven in its effects on our depository institutions. Equity capital losses have been particularly large in the Northeast, where banks have suffered extensive loan losses as a result of declining real estate prices and a bubble in real estate lending in the mid 1980s. Similarly, not all borrowers are equally affected by problems in the banking sector, since many borrowers depend almost entirely on financing unassociated with banks. Therefore, the current capital crunch primarily affects bank-dependent borrowers located in sectors of the country that have experienced large losses of capital.

Banks are but one of many sources of financing for many borrowers, particularly large ones. Depository institutions play a declining role in providing funds to the nonfinancial sector of the economy (Figure 1). The recent drop in the flow of depository credit primarily reflects the loss of intermediation services of the thrift industry. However, all depository institutions have had a diminished role in lending, as an increasing number of nonfinancial firms directly accessed national and international financial markets and many consumer and mortgage loans were held by nondepository institutions as a result of securitization. In addition, other financial intermediaries have begun to compete in markets traditionally dominated by depository institutions. This competition is likely to increase, as problems in the banking sector limit the ability of banks to compete effectively with other financial institutions.

In substantial measure, this period of tight credit is the result of a loss of bank capital, rather than a loss of deposits.

Thus, large firms and borrowers whose loans can easily be securitized will not be seriously hurt by the erosion in some banks' capital positions. The sector most likely to be affected is made up of small firms, which traditionally have relied heavily on bank credit to finance their operations. Banks have focused on this sector because lending to small firms requires an understanding of the local economy, the characteristics of small businesses, and the business acumen of management. Banks' expertise in evaluating and monitoring credit, particularly for these small privately held firms, has not been seriously invaded by competition from other financial intermediaries. But if this important source of financing is lost, small firms have few credit alternatives.

Existing relationships between borrowers and

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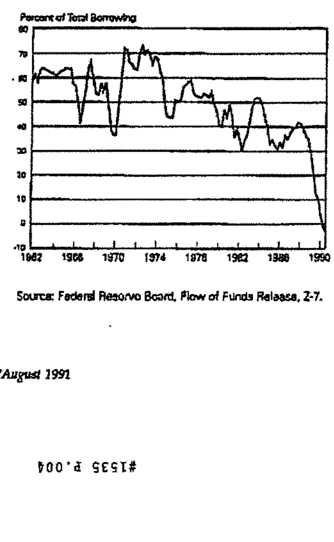
lenders are particularly important and often difficult to replicate for small businesses. Thus, when a current lender to small firms either goes out of business or cuts back its lending activity, many companies have an extraordinarily difficult time in developing new access to credit. A primary reason for this is the simple economics of business lending. In many ways, the costs of gathering and evaluating information are as great for a one-hundred-thousand-dollar loan as for a loan ten times that size.

Small businesses in New England have been particularly hurt by the capital crunch because the loss of bank capital is greatest in this region, which is also hardest hit by the recession (Figure 2). While the nation as a whole has maintained a relatively stable rate of growth of both bank capital and assets, the New England experience has been quite different. Capital and assets grew rapidly during the mid 1980s but have declined sharply since then.

The loss of bank capital in New England is particularly troubling. With little prospect of issuing new stock in the current economic environment, banks can restore their capital-to-asset ratio only by retaining more earnings and shrinking their assets.

Figure 1

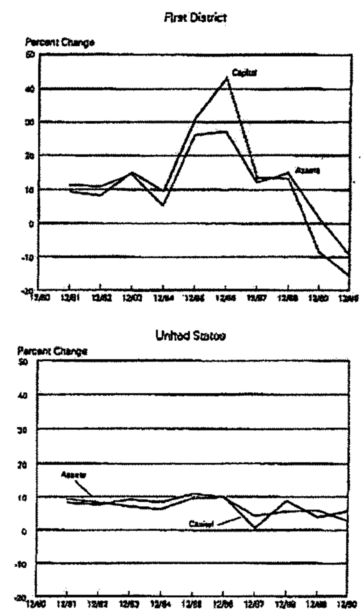
Funds Advanced by Commercial and Savings Banks Relative to Total Net Borrowing by the Domestic Nonfinancial Sector



Source: Federal Reserve Board, Flow of Funds Release, Z-7.

Figure 2

Percentage Change in Capital and Assets of Commercial and Savings Banks



Source: Call Report data for FDIC-insured institutions.

Many institutions in New England have been reducing their dividends and contracting their lending. In some areas this has made loans unavailable to otherwise creditworthy borrowers who are dependent on bank financing.

It is the loss of bank capital that differentiates credit availability at this stage of the current business cycle from similar periods previously. Thus, the an-

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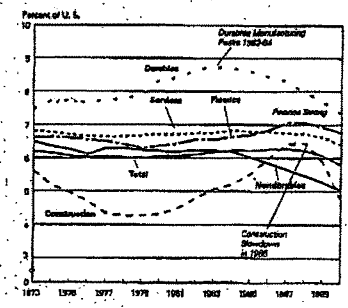
Figure 3

New England Employment as a Percentage of United States Employment, Major Industry Groupings



Rising construction and finance offset weak manufacturing in the late 1980s.

Source: U.S. Bureau of Labor Statistics.

swer to whether we are experiencing a credit crunch is yes, at least in that respect. Regions that have lost substantial bank capital are experiencing tighter credit conditions than they would otherwise. The major cause of this credit crunch is not monetary policy or changes in bank regulation, however, it is the loss of bank capital resulting from excessive credit growth during the mid 1980s. To understand our current problems with credit availability, it is essential to understand the changes in bank lending patterns that occurred in the 1980s.

Economic and Financial Developments in the 1980s

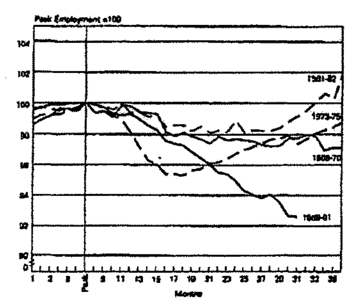
During the 1980s, many regions experienced business cycles out of sync with the country as a whole. The Southwest experienced an oil cycle, many Midwestern states experienced a farm cycle, and New England experienced a real estate cycle. Each of these cycles in the real economy has an analog in the financial economy.

During the 1980s, employment in New England increased gradually but steadily despite only modest increases in the population (Figure 3). However, this smooth growth in New England employment as a whole masked large swings in several industry groups. Manufacturing of durable goods, a traditional strength of New England, grew rapidly in the late 1970s and early 1980s, fueled by growth in computer and other high technology companies. However, employment in these industries peaked by 1984 and declined for the rest of the decade as New England computer manufacturers lost market share.

This decline in manufacturing did not cause a drop in overall employment because of a simultaneous increase in construction employment. New England's share of construction employment started to increase in the late 1970s and rose very sharply after 1983. The construction boom, in turn, helped stimulate support industries such as financial services. Thus, the decline in one of our major industries, durable goods manufacturing, was camouflaged by the extraordinary increase in construction and related industries.

Figure 4

Employment in Massachusetts during Periods of Recession
(Indexed to the Peak)



Source: *New England Economic Indicators* Database.

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Hearing Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs "Reforming the Regulation of the Government Sponsored Enterprises"

Testimony of Daniel H. Mudd

President and CEO, Fannie Mae

February 7, 2008

Washington, D.C.

Chairman Dodd, Ranking Member Shelby, and members of the Committee, I appreciate the opportunity to speak today, and thank you for again taking up the issue of GSE regulatory reform. Fannie Mae is committed to supporting your efforts to pass reform legislation in 2008.

Before I offer my comments on regulatory reform, I'd like to provide the Committee with a brief update. Fannie Mae has undergone significant change during a time when the mortgage and housing markets have themselves undergone significant change.

Fannie Mae has new management, and a completely revamped corporate governance and internal control environment. Only one hurdle remains for us to fully comply with the 81 remediation measures called for in our 2006 consent order with the Office of Federal Housing Enterprise Oversight. That hurdle is the filing of our fully audited 2007 results with the Securities and Exchange Commission, which will be done at the end of this month.

We believe the internal improvements we have made since 2005 have helped us meet an external challenge: Maintaining liquidity, stability and affordability in the prime, conventional, conforming mortgage market during a period of extraordinary market stress. While subprime, jumbo and other non-conforming markets have shrunk or shut down completely, the center of the market where the GSEs have a large presence has performed relatively well. Credit remains readily available and rates have fallen for GSE-eligible loans.

Having said that, we are not immune from the disruptions in the market and we will take our lumps. In fact, we had a GAAP loss in the third quarter and we saw more difficult headwinds in the fourth quarter. But our business is meeting the increased demand for liquidity and our overall credit book has held up relatively well. Yes, these are tough times, but that is when you want a Fannie Mae.

The mortgage crisis in this country is widespread and growing. Economically distressed communities are being ravaged by foreclosures, and waves of subprime teaser rate "resets" are crashing over thousands of homeowners every month. The GSEs have an important role to play in helping the market through these problems. Both companies are doing loan workout and foreclosure prevention programs on a large scale. Through its HomeStay initiative, Fannie Mae successfully refinanced 68,000 subprime borrowers into prime, fixed-rate loans in 2007. In addition, we worked with more than 43,000 delinquent borrowers to help them stay in their homes. We've contributed nearly $9 million to non-profit mortgage counselors so they have the capacity to meet the growing demand for help. And, most importantly, we continue to maintain a stable, liquid center of the mortgage market so that credit-worthy borrowers can access affordable mortgages.

Such efforts on the part of Fannie Mae are worth considering as Congress and the administration take up the issue of reforming the regulatory regime of the GSEs. The choices you make now should be durable and stand the test of time. We support the creation of a strong, independent and bank-like regulator that can not only provide proper oversight, but can ensure the GSEs are able to respond to the changing – and sometimes volatile — housing and mortgage markets.

We recognize the tensions at the very heart of the GSE charter — the tension between the interests of a private enterprise and the public interest; the tension between avoiding risk for safety's sake and embracing risk for the sake of expanding homeownership and affordable housing. Regulatory reform calls for that same balance: The need for a nimble, responsive, creative housing enterprise balanced with sound, professional regulatory oversight.

Mr. Chairman, you have asked me to comment on proposed legislation to strengthen that oversight. Our view of the principles that should guide regulatory reform has remained unchanged since I first testified before this committee on April 20, 2005. But the dramatic changes in the housing market that began last year only reinforce our views of key elements of regulatory reform. These views focus on:

- Our capital.
- The role of our mortgage portfolio.
- The products and programs we pursue.
- And our performance in funding affordable housing.

Capital

With respect to capital, the current housing crisis has reinforced two things. First, financial institutions need to have enough capital to weather a downturn, and second, in times like these, it is critical that they have enough capital to continue delivering liquidity to the market.

This is the balance we have been trying to strike. We presently have more capital than at any time in our existence as a public company. This will protect us from the downside impact of the housing crisis. It will also permit us to provide service to the market in its time of need and ultimately to generate earnings to maintain and build capital. That is the balance struck in banking regulation, and the balance we seek in GSE regulation.

Congress has established a statutory minimum capital standard for Fannie Mae and Freddie Mac that reflects the unique role of the government sponsored enterprises and the importance of capital in meeting their liquidity, stability and affordability mission. We support this Committee's re-affirmation of our minimum statutory capital requirement in S. 190, in the 109^{th} Congress, and the House's more recent re-affirmation in H.R. 1427.

As I have said before, the normal capital levels established by Congress for normal times should be the norm.

We also support the regulator's ability to increase our capital requirements when necessary to meet a clearly articulated safety and soundness concern. But when such concerns are absent, legislation should ensure that our capital requirements return to the levels established by Congress.

Portfolio

On portfolio oversight, we believe the bank regulation approach strikes the right balance of ensuring safety and soundness and market responsiveness, and would work for the GSEs as well.

During times of illiquidity, Fannie Mae's mortgage portfolio has grown to replace capital that flees the mortgage market. This happened during past real estate and liquidity crises in the 1980s, 1990s and early this decade. More recently, even though our portfolio growth is presently limited by our consent order, Fannie Mae has allocated increased investment to affordable rental housing, a market that other investors have abandoned.

We support regulation ensuring that the GSEs' mortgage portfolios are managed in a safe and sound manner. But regulation should not impose arbitrary limits, including a so-called "systemic risk" standard, on the GSEs' portfolios. Particularly when markets are weak, the GSEs need flexibility to expand their portfolios in order to achieve their mission of providing the liquidity the markets need. Indeed, bank regulators have consistently taken the approach that asset growth, by itself, does not cause a safety and soundness risk – only unplanned or poorly managed asset growth.

I dispute the notion that our portfolio is somehow exempted from the laws of gravity, or supply and demand, or conditions in the capital markets. That is why you see month-to-month growth and contraction in the size of our portfolio. Conditions change. When they do, and it makes sense, we grow, shrink or hold our investments.

To that end, we therefore support legislation clearly identifying the bank-like safety and soundness factors that would guide regulatory oversight of our portfolio.

New Product Approval

Another area that would improve and strengthen regulation is the consolidation of product approval with safety and soundness regulation. We believe our regulator should have oversight of the products and business initiatives we pursue, to make sure they are within our charter and are subject to safety and soundness controls, just like other financial institutions.

It is also important that the regulatory oversight process be efficient. Imposing a cumbersome pre-approval process or public notice and comment period would only impede our ability to serve the modern mortgage market.

A public notice and comment process would be contrary to any bank regulatory process of which we are aware. No other regulatory regime requires public disclosure of most new business initiatives.

Particularly during times of extraordinary disruption and change, like today, the GSEs must move quickly to address the pressing needs of the primary mortgage market. HomeStay, our initiative responding to the subprime crisis that I mentioned earlier, is an example. Our customers and partners in the lending community asked for a solution, and we provided one, in a matter of days. Our regulator, of course, reviewed it, and encouraged us to move ahead.

Another example is our quick response to hurricanes Katrina and Rita. Among the many targeted initiatives were:

- Underwriting flexibilities on new loans for borrowers affected by the hurricanes.
- Servicing flexibilities with respect to existing borrowers affected by the hurricanes.
- Providing 1,500 Fannie Mae properties to families displaced by the hurricanes.

Any of these business decisions could be considered "new products."

In this area as well, the bank regulation model offers what we believe is the best guide. Banks keep regulators apprised of new business initiatives through the examination process and by regular communication with their examiners. So should the GSEs. In practice, banks consult their regulators routinely on significant business plans and developments without public notice and approval for every product innovation or new activity, except for a few exceptions, such as bank mergers or acquisitions. Well-capitalized, well-managed banks are able to offer new products and innovate to meet market demands without a burdensome pre-approval process. Subjecting every new initiative to a public inquiry through notice and comment periods would be unworkable for any bank. The GSEs are no different.

Affordable Housing

Lastly, any new regulatory regime should reinforce the GSEs' mission to provide capital for affordable housing. Today, this responsibility is enforced by the Department of Housing and Urban Development under a complex and outdated system of goals that neither reflect the most current market data nor adapt to changing market conditions. These goals were established during a prolonged period of home price growth, and they assume that the primary mortgage lending market, which the GSEs do not control, will be able to deliver an increasing level of affordable housing mortgages steadily, through every market cycle. But the market has its own logic, as do home prices.

We support a different approach, with two key components. First, the GSEs' regulator should set and oversee streamlined affordable housing goals that reflect current market data and adapt to changing market conditions. The regulator should evaluate the totality of our results at expanding affordable housing.

Second, Fannie Mae supports the creation of an Affordable Housing Fund, to be funded from the GSEs' net income and integrated into a new affordable housing goals regime. We believe the GSEs to manage the fund in regular consultation with Congress and our regulator, including filing an annual plan and report on our efforts. We should manage the fund, and we should be held accountable for the results.

Conclusion

Mr. Chairman, you've asked me to come to this hearing to express Fannie Mae's views on GSE regulatory reform. We believe H.R. 1427, which was passed by the House last year with bipartisan support, offers a sound basis upon which to build a lasting regulatory regime for Fannie Mae and Freddie Mac. The housing and mortgage markets need certainty and stability at this time, and strengthening oversight will provide an additional measure of confidence that the GSEs will be here doing our job the right way for the long run.

Thank you for the opportunity to be here today.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM DAVID G. NASON

One of the areas that I believe needs more debate and vetting is the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund. Fannie and Freddie have affordable housing goals, the Federal Home Loan Banks have an affordable housing program, and the House passed GSE reform legislation would establish a new housing fund with goals. The most recent GSE reform legislation that passed the Senate Banking Committee did not have a housing fund.

Q.1. What are the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund like the House approach?

A.1 All three approaches have similar goals of ensuring that government sponsored enterprises undertake activities that are consistent with a public purpose mission.

Affordable housing goals for Fannie Mae and Freddie Mac under the existing regulatory structure were originally required by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 and established by the Department of Housing and Urban Development (HUD). The current goals were set by HUD in 2004. The goals are specified in terms of low- and moderate-income housing, special affordable housing, and underserved areas housing. HUD's current affordable housing goal regulation sets the goals at levels that require Fannie Mae and Freddie Mac to be market leaders in the housing goal categories. Affordable housing goals focus more on broad market segments and the GSEs' relationship to overall market activity.

The Federal Home Loan Bank (FHLBank) System's Affordable Housing Program (AHP) and the affordable housing fund contained in H.R. 1427 are similar approaches in that a portion of the GSEs' income is redirected toward affordable housing activities. Unlike Fannie Mae and Freddie Mac, the FHLBank System does not have a specific statutory mission. Instead, the FHLBanks generally support housing finance by virtue of the nature of their authorized activities. The FHLBanks' AHP was mandated by the 1989 thrift legislation and established by regulation in 1990.

Some key structural differences between the FHLBank's AHP program and affordable housing fund contained in H.R. 1427 include the basis and amount for the assessment, and the administration of the fund. The FHLBanks' AHP requires 10 percent of net income (since the FHLBanks do not pay Federal taxes, this is comparable to 10 percent of before tax income of other companies), while the trust fund requires 1.2 basis points for each dollar of the average total mortgage portfolio of each enterprise during the preceding year. Disbursement of funds from the FHLBanks' AHP is administered by the FHLBanks, through member financial institutions, while the disbursement of funds from the affordable housing fund contained in H.R. 1427 is administered by the Director of the new housing GSE regulator in consultation with the Secretary of HUD and is based on regulations. The latter feature regarding administering the trust fund is intended to prevent the fund from being used for political purposes. The funds are granted to states or state agencies for distribution.

Q.2. If we go down the track of creating a housing program or housing trust fund for Fannie and Freddie, what is the appropriate amount of resources that should be spent, who should allocate the funds, and how should the funds be spent?

A.2. We strongly oppose the establishment of an affordable housing fund for Fannie Mae and Freddie Mac. This proposal would create an undue and counterproductive reliance on Fannie Mae and Freddie Mac by tying the potentially unlimited growth of an affordable housing fund to the annual amount of the GSEs' mortgage business. In addition, such an affordable housing fund could be susceptible to political influences that could compromise the goals of assisting as many low income families in need as possible. If an affordable housing fund is going to be part of this legislation, the fund must be controlled by the Federal government (not by Fannie Mae and Freddie Mac), temporary, and capped.

Q.3. Does it make sense to have both housing goals and a housing program for Fannie and Freddie?

A.3. Housing goals can provide a broad focus to the overall business of a GSE, while affordable housing programs can provide assistance to more specific projects.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BAYH FROM JAMES B. LOCKHART III

A.1. OFHEO responded to the egregious accounting errors and serious systems and operational risk management failures at Fannie Mae and Freddie Mac by ensuring the replacement of senior managers and outside auditors, the hiring of competent staff, the development of GAAP compliant accounting policies and of operational control systems throughout the Enterprises, transparent public disclosures, and fundamental changes in their corporate cultures. The fines paid by Fannie Mae and Freddie Mac to OFHEO and the SEC were a strong signal to their Boards, management, shareholders and debt and MBS investors that this behavior would not be tolerated in the future. The fines amounted to an average of half of one percent of core capital after tax, not enough to materially affect their safety and soundness. Of considerable consequence, though, was our decision to raise capital requirements at both Enterprises by 30 percent and to restrict asset portfolio growth and insist on adequate controls for new product development. Without these actions, I seriously doubt that either Enterprise would be playing a constructive role in mortgage finance markets today.

A.2. During normal times, the Enterprises perform their principal function by guaranteeing mortgage-backed securities (MBS). Purchasing their own MBS and issuing debt to finance the purchase generally provides little additional benefit. While the Enterprises' debt and MBS are not perfect substitutes, both have been highly sought after by investors around the world. Yields on the two types of securities generally are closely related, with differences reflecting their different payment structures. In the current environment, the two markets are less well integrated. Because of that, and because both Enterprises have finally completed most of their remediation, we have reached agreements with the Enterprises that eliminated their portfolio restrictions, lowered their required capital requirements and assured that they will each raise more capital so that they can better fulfill their missions. That is what is required in these difficult market conditions. Legislation should provide the regulator with the ability to adjust portfolios according to the circumstances. Any size limitations on these portfolios would be pursuant to notice and comment rulemaking.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM JAMES B. LOCKHART III

Q.1. What are the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund like the House approach?

A.1. The Affordable Housing Program (AHP) of the Federal Home Loan Banks (FHLBs) was established in the 1989 law that created the Federal Housing Finance Board (FHFB). The AHP is expressed in terms of monetary contributions by the FHLBs, and mandated contributions reflect the relative profitability of each FHLB. The AHP most often works in conjunction with other (non-FHLB) forms of housing assistance to make individual affordable housing projects viable. The AHP is generally seen as an effective form of affordable housing assistance. The funds are relatively well-targeted, but the size of the program is limited. The program is in addition to the primary programs of the FHLBs.

The affordable housing goals now in effect for Fannie Mae and Freddie Mac are outlined in the 1992 law that created OFHEO. The goals are established by regulation by the HUD Secretary, and compliance is monitored and enforced by HUD. The underlying rationale for the 1992 goals is Congress' view that the Enterprises "have an affirmative obligation to facilitate the financing of affordable housing . . . consistent with their overall public purposes." The goals, which are expressed as a percentage of each Enterprise's overall business, are intended to affect the way the Enterprises carry out their primary programs. In practice, the goals have proven important in directing Enterprise activity, but are less nimble as a result of being set in statute. Both H.R. 1427 and S. 2391 revise the framework for the goals, but the framework remains fairly rigid.

H.R. 1427's affordable housing fund was structured to ensure a steady monetary contribution by the Enterprises to affordable housing. In the House-passed bill, annual funding is based on the Enterprises' books of business (as opposed to being expressed as a percentage of profits). A similar fund is created under S. 2391. There are significant differences between the House and Senate measures, but both mandate a monetary contribution that is allocated among qualifying entities. Both bills allow for temporary suspension of contributions for reasons related to financial instability or inadequate capital. Creating a new constituency dependent on Enterprise earnings could add pressure to increase business at the expense of safety and soundness.

Q.2. If we go down the track of creating a housing program or housing trust fund for Fannie and Freddie, what is the appropriate amount of resources that should be spent, who should allocate the funds, and how should the funds be spent?

A.2. If Congress makes a judgment to create an affordable housing fund, it is important that the funds raised not be so large as to raise safety and soundness concerns, and I think the fund would work more effectively if it receives a relatively stable flow of funds from year to year. Finally, I think it is important that any new housing fund should not be controlled by the Enterprises, since such control greatly increases the potential for allocations based on what is in the Enterprises' best interests, rather than on what will best address affordable housing needs. It should also be subject to a sunset test to ensure that it is working.

Q.3. Does it seem to make sense to have both housing goals and a housing program for Fannie and Freddie?

A.3. This decision will reflect Congress' view about the degree to which the balance between the Enterprises' public mission to support affordable housing and each company's need to retain shareholder support. Affordable housing goals and an affordable housing fund can function in complementary ways, but a combination of the two is undeniably a greater burden for the companies than either obligation alone would be. One approach might be to reflect in their affordable housing goals the impact of affordable housing grants.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN DODD FROM RONALD A. ROSENFELD

POTENTIAL MERGER OF DALLAS AND CHICAGO HOME LOAN BANKS

Chairman Rosenfeld, as we discussed at the hearing, the American Banker reported on February 5 that the boards of directors of the Federal Home Loan Banks of Dallas and Chicago have voted to approve a merger of the two Banks. You stated that the merger application has not yet been presented to the Finance Board and that therefore you have not developed standards or processes for deciding whether to approve that merger. You also stated that in your view, this is simply a matter between the two Banks. I would appreciate your response to the following additional questions:

Q.1. What is the statutory authority under which two Banks may voluntarily merge? Which specific statutory provisions address the Finance Board's authority to approve or disapprove a merger between two Banks?

A.1. Section 26 of the Federal Home Loan Bank Act (Bank Act) authorizes the Finance Board to liquidate or reorganize any Federal Home Loan Bank (FHLBank) "[w]henever the Board finds that the efficient and economical accomplishment of the purposes of [the Bank Act] will be aided by such action." The term "reorganize" is not defined by the Bank Act, but it is my view that it includes an acquisition of one FHLBank by another FHLBank, whether the acquisition is structured as a merger, a purchase and assumption transaction, or otherwise. The statute expressly provides that one

FHLBank may acquire assets and assume liabilities of another FHLBank, either in whole or in part.

This provision of the Bank Act represents a substantial delegation of authority to the Finance Board. It requires only that the action must "aid" the achievement of the statutory purposes. It does not require a finding of insolvency or severe financial distress. This construction of section 26 is consistent with other provisions of the Bank Act, such as section 3, which gives the Finance Board broad discretion to reduce the number of Bank districts to as few as eight, and section 25, which provides that "each [Bank] shall have succession until dissolved by the Finance Board or by act of Congress."

The predecessor to the Finance Board exercised the authority conferred by section 26 on one occasion, in 1946, when it merged the Los Angeles Bank into the Portland Bank, and relocated the successor FHLBank to San Francisco. That action was taken over the objection of the Los Angeles Bank. In *Fahey v. O'Melveny & Myers*, 200 F.2d 420 (9th Cir. 1952), the United States Court of Appeals for the Ninth Circuit rejected a challenge to the merger, confirming the broad delegation reflected in section 26.

Q.2. Given that the Banks are all jointly and severally liable for each other's debt, the other 10 Banks have a clear interest in the financial condition of the Dallas and Chicago Banks. Furthermore, any standards that are developed as part of this process could set a precedent for the future. Therefore I do not believe that this is merely a matter between the two Banks. Since the hearing, what consideration have you given to the standards you would use to review a merger application?

A.2. With regard to the financial condition of the Dallas and Chicago Banks, all of the FHLBanks have registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, and all of them are current in their filings with the SEC. Before the end of March, I expect that the Chicago and Dallas Banks will file their annual reports, on Form 10–K, with the SEC. Form 10–K filings include a full set of audited financial statements, which will provide all interested parties an opportunity to evaluate the current financial condition of the Dallas and Chicago Banks. By requiring the FHLBanks to register with the SEC, the Finance Board sought to promote uniform financial disclosure that would allow each of the FHLBanks, as well as any other interested parties, to evaluate the financial condition of any of the FHLBanks.

With regard to the standards for approving any merger of two FHLBanks, the general standards are set by statute. Under Section 26 of the Bank Act, as noted above, the Finance Board may order or approve a "reorganization" of an FHLBank if it determines that the "efficient and economical accomplishment of the purposes of [the Bank Act] will be aided by such action." The purposes of the Bank Act are reflected in the statutory duties imposed by Congress on the Finance Board in Section 2A of the Bank Act. The Finance Board has the primary statutory duty of ensuring that the FHLBanks operate in a financially safe and sound manner. To the extent consistent with this primary duty, the Finance Board is also required to ensure: (1) that the FHLBanks remain adequately capitalized and able to raise funds in the capital markets; and (2) that the FHLBanks carry out their housing finance mission.

Accordingly, if the Chicago and Dallas Banks submit a merger proposal, the Finance Board would evaluate the proposal in light of those standards. The Finance Board's paramount concern would be to determine whether the resulting FHLBank would be able to operate in a safe and sound manner following the merger. The Finance Board also would evaluate whether the resulting FHLBank would remain adequately capitalized and able to raise funds in the capital markets after the transaction had closed. Finally, the Finance Board would evaluate whether the resulting FHLBank would be able to meet the housing finance needs of all of its members to the same degree, or better, than the Chicago and Dallas Banks are doing at present.

Q.3. It seems to me that the decision confronting the Finance Board when the merger application is submitted is sufficiently significant that the process must be transparent and the impact of the decision on the System as a whole must be recognized. What do you believe are the elements necessary to ensure a transparent decision-making process?

A.3. I believe that the process will be transparent at several levels. If the Dallas and Chicago Banks enter into a definitive agreement and submit it to the Finance Board for approval, I expect that they will file a Form 8–K with the SEC to announce that development, and will include key details and information about the transaction. Thus, once that event has occurred, any interested party will be able to analyze the terms of the transaction and determine how they may be affected by the merger.

It is also my expectation that the Dallas and Chicago Banks would develop a joint disclosure document along the lines of a SEC-compliant proxy statement. They would provide that document, which would describe in detail the terms of the proposed merger and the effect on the members, to all of the members of both FHLBanks. I further expect that they would conduct a number of member outreach meetings to inform the members as to the terms of the transaction and the reasons why the board of directors of each FHLBank has determined that the transaction is in its best interest. Although the Bank Act does not authorize the members to vote on such a transaction, the information in the disclosure documents would allow them to evaluate the transaction and express any concerns they might have to their respective FHLBank's board of directors.

In considering the merits of any merger proposal, I believe that the Finance Board must evaluate how the proposed merger may affect the safety and soundness, capital adequacy, and mission achievement aspects of not only the Dallas and Chicago Banks, but of the other ten FHLBanks as well.

PROBLEMS AT THE CHICAGO BANK

Q.4. The Home Loan Bank of Chicago is now operating under a cease and desist order issued by the Finance Board on October 10, 2007. The cease and desist order supersedes the Supervisory Agreement issued by the Finance Board on June 30, 2004. The 2004 agreement was itself issued as a result of the Chicago Bank's failure to address items identified in the Bank's 2003 examination. Given that the problems identified at the Chicago Bank over four years ago have yet to be remedied, what steps is the Finance Board taking to ensure that the Bank's problems do not pose a risk to the System as a whole? If the Chicago Bank and the Dallas Bank merge, how will the Finance Board ensure that the resulting entity addresses these problems?

A.4. On October 10, 2007, the Finance Board placed the Federal Home Loan Bank of Chicago under a cease and desist order (Order). That action was taken to ensure that the Chicago Bank's problems are addressed by current management in a timely manner and that they do not "spill over" to threaten the System as a whole. Among other things, the Order prevents the Chicago Bank from repurchasing or redeeming capital stock, or from paying dividends, without the prior written approval of the Finance Board's Director of the Office of Supervision. The Order also requires the Chicago Bank to improve its risk management practices and to maintain a minimum ratio of capital stock, retained earnings, and subordinated debt to total assets of at least 4.5 percent. Although the specific provisions of the Order are intended to reduce the Chicago Bank's risk exposures, the Order itself cannot ensure that the Chicago Bank's management and board of directors will succeed in addressing its problems effectively and in a timely manner. Thus, we are closely monitoring the Chicago Bank's financial condition, performance, and activities to ensure that it is progressing satisfactorily.

It is incumbent upon the Dallas and Chicago Banks to demonstrate to the satisfaction of their respective stakeholders and the Finance board that the proposed merger will succeed. The Finance Board will carefully review the terms and conditions of the proposed merger once they are finalized to ensure that the supervisory issues concerning the Chicago Bank will be fully addressed. The Finance Board will also assess the financial and managerial resources and earnings prospects of the resulting entity.

FEDERAL HOME LOAN BANKS' RESPONSE TO THE HOUSING CRISIS

Our nation is currently in the midst of a housing crisis, with record numbers of Americans facing foreclosure. The Federal financial regulators have issued guidance regarding the underwriting of nontraditional and subprime mortgages. These guidelines require underwriting that more effectively establishes a borrower's ability to repay the mortgage being made.

Q.5. When did the Finance Board adopt these standards for determining what mortgages are eligible collateral for the Home Loan Banks to accept for advances or are eligible to be purchased as acquired member assets?

A.5. The Finance Board, through its Office of Supervision, issued Advisory Bulletin 2007–AB–01, "Nontraditional and Subprime Residential Mortgage Loans," on April 12, 2007. This advisory bulletin requires, in part, that each FHLBank adopt and implement policies and risk management practices as part of its credit risk management program that establish appropriate risk limits for, and appropriate mitigation of, credit exposure on nontraditional and subprime mortgage loans. We evaluate each FHLBank's compliance with this advisory bulletin through our examination program, taking into consideration market conditions and guidance issued by the Federal bank regulatory agencies.

Additionally, in November 2007, we issued an internal bulletin to our examiners that provided guidance on assessing credit and reputational risks associated with investing in private-label MBS that are backed by subprime and nontraditional residential mortgage loans. This bulletin instructed examiners to, in part, determine whether the FHLBank's private-label MBS investments have increased since the Federal Financial Institutions Examination Council (FFIEC) agencies issued their guidance on nontraditional mortgage product risks in October 2006 and, if so, whether additional investments in private-label MBS with underlying subprime and nontraditional mortgage loans consist of loans that conform to FFIEC agency guidance.

In December 2007, as part of our ongoing supervisory efforts and, in particular, those ensuing from Advisory Bulletin 2007–AB–01, our Examiners-in-Charge contacted each FHLBank to express our expectations that FHLBank policies and processes regarding subprime and nontraditional mortgages should include requirements that the FHLBank will not include in its collateral coverage calculations loans that do not comply with FFIEC guidance on subprime and nontraditional mortgages for those loans originated after the FFIEC guidance was issued. We are preparing an advisory bulletin to formalize this communication, as well as our expectations that loans that underlie private-label MBS investments or that are purchased through the FHLBanks acquired member assets programs should similarly comply with FFIEC guidance. We expect that this advisory bulletin will be issued within 30 days.

Q.6. Were these types of loans eligible collateral prior to that guidance being adopted? If so, what has the Finance Board done to ensure that such loans are no longer being used as collateral, and how much collateral has been affected?

A.6. As regulator of the Federal Home Loan Banks, our supervisory efforts consider the conditions in the financial marketplace and the FHLBanks' mission. The FHLBanks provide financial products and services to members and housing associates, including, but not limited to, advances that are used to assist in financing single-family and multi-family housing for consumers at all income levels. The use of nontraditional and subprime residential mortgage loans, when appropriately underwritten, may have provided and may continue to provide consumers with greater credit options for purposes of home ownership. However, when inappropriately marketed, underwritten, and managed, these loans often are associated with increased credit or reputational risk for financial institutions and an increased propensity for financial difficulty for the borrowers.

As a general matter, we have not taken exception to the FHLBanks accepting appropriately underwritten subprime and nontraditional mortgages as collateral for advances provided that they have adopted adequate policies and procedures for doing so. As noted in our response to the preceding question, in December

2007 we contacted each FHLBank to express our expectations that FHLBank policies and processes regarding subprime and nontraditional mortgages should include requirements that the FHLBank will not include in its collateral coverage calculations loans that do not comply with FFIEC guidance on subprime and nontraditional mortgages for those loans originated after the FFIEC guidance was issued. We are preparing an advisory bulletin to formalize this communication, as well as our expectations that loans that underlie private-label MBS investments or that are purchased through the FHLBanks acquired member assets programs should similarly comply with FFIEC guidance.

Q.7. What additional steps do you believe the Home Loan Banks can take to ensure that they are doing all they can both to stop abusive lending practices and to help keep people in their homes?

A.7. The Finance Board, through its Office of Supervision, issued Advisory Bulletin 2005–AB–08, "Guidance on Federal Home Loan Bank Anti-Predatory Lending Policies," on August 25, 2005. This advisory bulletin required each FHLBank to adopt comprehensive anti-predatory lending policies to govern the FHLBank's purchasing of mortgages and calculating the level of advances that can be made to its members. The guidance requires that the FHLBanks' policies preclude purchasing mortgages that violate applicable federal, state, or local predatory lending laws or including such loans when calculating the level of advances that can be made to a member. The guidance also requires that the FHLBanks' policies address such features as mortgages subject to the Home Ownership and Equity Protection Act (HOEPA); prepaid single-premium credit life or similar insurance; prepayment penalties beyond the early years of the loan; and mandatory arbitration. Each FHLBank has developed written procedures and standards for verifying member compliance with its anti-predatory lending mortgage purchase and advance policies. The FHLBanks can help curb abusive lending practices by vigorously ensuring compliance with these policies. Our examination program includes monitoring the FHLBanks' adherence to their policies and practices.

The FHLBanks can help keep people in their homes by fulfilling their mission, including making advances that assist and enhance their members' financing of housing, including single-family and multi-family housing serving consumers at all income levels. Since liquidity in the housing and financial markets faltered last year, advances at the FHLBanks have increased substantially. Between June 30, 2007 and February 13, 2008, advances increased by $234 billion, providing liquidity to members and, in turn, the housing finance market.

In addition, the FHLBanks can further assist with homeownership stability by using their affordable housing and community lending programs in innovative ways. For example, the Federal Home Loan Bank of San Francisco, after receiving certain regulatory waivers from the Finance Board, is establishing a program under which it will provide Affordable Housing Program grant subsidies on a noncompetitive basis to refinance or restructure low- or moderate-income borrowers' existing nontraditional adjustable rate mortgage loans that are held by members or their affiliates of the

FHLBank. The program applies to all such loans when they have become unaffordable to those households, or are projected to become unaffordable, because of increased payments resulting from adjustments in the interest rates or loan principal that occur subsequent to origination. The Finance Board has initiated a review of the AHP regulation to consider changes to the regulation that would allow other FHLBank similar authority.

Further, the Federal Home Loan Bank of Indianapolis (FHLBI) has created a $100 million lending initiative, HomeRetain, to help FHLBI financial institution members assist families facing foreclosure. HomeRetain is a part of the FHLBI's Community Investment Program. Through HomeRetain, FHLBI will make available funding to its member financial institutions at the FHLBI's cost of funds, plus a small administrative markup. Member financial institutions can then use the funds to help homeowners at risk of foreclosure to refinance their homes or modify their mortgages on more favorable terms. Additionally, last year, the Federal Home Loan Bank of Cincinnati started a HomeProtect Program, which makes available $250 million in advances to member financial institutions at its cost of funds for purposes similar to the Indianapolis Bank's HomeRetain program.

FINANCE BOARD'S REVIEW OF COLLATERAL

Q.8. What is the Finance Board's process for reviewing the collateral pledged by the Banks' members? Does the Finance Board review collateral pledged by individual institutions to see if they are pledging housing-related assets and are not simply pledging Treasuries, for example? To what extent does the Finance Board monitor the characteristics of mortgage loans that are pledged as collateral, such as borrower income levels, geographic distribution, etc.?

A.8. The Finance Board uses two processes to monitor collateral pledged by the FHLBanks' members. First, our examiners evaluate collateral operations during on-site examinations, which we conduct annually for each FHLBank. Specifically, the examiners assess the adequacy of the Banks' monitoring of collateral pledged by members. In this regard, we expect the FHLBanks to obtain collateral information from their members, on a quarterly basis, that shows the volume and types of loans pledged. Our examiners also evaluate the FHLBanks' oversight process, in which the FHLBanks assess their members' compliance with pledging requirements. The second process is the Finance Board's annual collateral survey, which is used to gather information on the FHLBanks' collateral management practices, including the types of collateral accepted, the characteristics of that collateral, and the discounts, or "haircuts," the FHLBanks apply to collateral to ensure that collateral values exceed credit exposures.

Under the Bank Act, all advances to members must be fully secured by collateral. The FHLBank must obtain and maintain a security interest in "eligible collateral" which includes: (1) whole first mortgages on improved residential property (not more than 90 days delinquent), or securities representing a whole interest in such mortgages; (2) securities issued, insured, or guaranteed by the United States Government or any agency thereof; (3) cash or deposits of a Federal Home Loan Bank; (4) other real estate related collateral acceptable to the Bank, if such collateral has a readily ascertainable value and the Bank can perfect its interest in the collateral; and (5) in the case of any member that qualifies as a "community financial institution", secured loans for small business, agriculture, or securities representing a whole interest in such secured loans. If the collateral securing an advance is insufficient to fully secure the advance, the member must reduce the advance promptly and prudently in accordance with a schedule determined by the FHLBank.

Most FHLBanks use a "blanket lien" to secure their credit exposures to members. Blanket lien agreements differ among the FHLBanks in terms of the assets of the member that are covered by the blanket lien. For example, a blanket lien may cover all assets of a member, only the financial assets of a member, or it might cover only 1–4 family residential mortgage loans. As a matter of practice within the FHLBank System, when a blanket lien is used to secure collateral, the blanket lien will, at a minimum, cover all 1–4 family mortgage loans.

In lieu of a blanket lien, an FHLBank may require a "specific listing" of collateral from a member. Some FHLBanks view a listing requirement as a stronger form of collateral control than a blanket lien. FHLBanks often use a listing requirement for members that exhibit a higher than normal risk profile. Under a listing requirement, an FHLBank obtains loan level information from the member on all collateral that is pledged. The information is typically updated on a quarterly basis.

FHLBanks can also take possession of a member's collateral by requiring the member to "deliver" any collateral securing an advance. Delivery is generally required if securities are used to secure an advance or if the risk profile of the member is a matter of concern. FHLBanks can require delivery of collateral to the FHLBank's premises or to a third party custodian.

When examiners review the collateral that a member pledges to secure an advance, the focus is on whether the collateral that is pledged is "eligible collateral" and whether the value of the collateral is sufficient to fully secure the advance. Because Treasury securities are eligible collateral for advances under the Bank Act, an FHLBank may accept them as collateral if it wishes to do so; the Bank Act does not require an FHLBank to prefer housing-related collateral over Treasury securities.

As a general rule, examiners do not monitor the characteristics of mortgage loans that are pledged as collateral, such as borrower income levels or geographic distribution. Again, the primary focus is on whether the collateral pledged is eligible collateral and whether the value of the collateral is sufficient to fully secure the advance. However, where examiners are concerned about the value of collateral securing a particular advance, they would review the characteristics of the mortgage loans that are pledged as collateral to ensure that the collateral is not overvalued by the member.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BAYH FROM RONALD A. ROSENFELD

Q.1. I have reviewed the decision making process of regulatory boards and commissions and believe that a board structure results in much better regulatory decision making than a single person regulator. In your experience at FHFB, have you had experiences where the interplay with your colleagues on the Board of Directors has resulted in better decision making than would have been the case if there were only a single regulator?

A.1. Both models, organizations with a board of directors and those with a single person regulator, can work. Each has its benefits and costs and there are times and circumstances when one model may be better than the other. The decision making process in a board or commission model benefits from the different perspectives brought to the table. A drawback might be that a board is not always able to act as quickly as circumstances might require. Often it is the strength and abilities of the individual or individuals that make an organization effective and efficient, and less about the structure.

Having said that, from my experience as Chairman of the Federal Housing Finance Board, I have been a party to decisions where the collaboration of members of the board made the process better. I would say our rule making process, for example, benefits as much from the collaboration of the board members before a rule is proposed as it does from the comments we receive from the public stakeholders before making the rule final.

With respect to government sponsored enterprise (GSE) reform, the more critical question is whether a full-time board is necessary for an organization whose regulated entities would number only 14, all of which are in the same basic business of furthering housing finance. I believe the policy making and stewardship responsibilities in such an organization can be carried out effectively through an advisory board, as proposed in the House of Representatives-approved GSE legislation, H.R. 1427 (H.R. 1427). The bill calls for a single agency responsible for the supervision and regulation of the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. A single regulator would lead the agency, acting with the benefit of guidance from an advisory board comprising the Secretary of the Treasury, the Secretary of Housing and Urban Development (HUD), and the Chairman of the Federal Reserve Board. The advisory board would establish the governing principles and standards critical to carrying out the responsibility of overseeing the housing GSEs.

Q.2. In reviewing the statutory authorities of the FHFB and OFHEO it appears that the FHFB has all of the authorities and independence needed of a strong regulator, and OFHEO is seriously deficient. Why did you not simply suggest that the regulation of Fannie Mae and Freddie Mac be moved to the FHFB and subject the enterprises to the FHFB statute?

A.2. I do not believe that there is a simple way, such as subjecting Fannie Mae and Freddie Mac to the Federal Home Loan Bank Act, to address GSE reform. Any reconfiguration of the regulatory structure for the oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks will require extensive amendments to the key regulatory statutes, *i.e.,* the Bank Act and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Housing Act), as well as conforming amendments to the Federal National Mortgage Association Charter Act and the Federal Home Loan Mortgage Corporation Act. This would be true regardless of whether the Finance Board, Office of Federal Housing Enterprise Oversight (OFHEO), or a newly created agency were to be charged with supervising all of these entities.

The Administration has advocated the creation of a new agency headed by a single director and would use the Housing Act as the primary vehicle to achieve that result. The GSE reform bill passed by the House of Representatives, H.R. 1427, followed that same approach. I see no reason to question the wisdom of that approach, nor do I believe that using the Bank Act as the vehicle for a new regulatory structure would necessarily result in a more effective regulatory agency.

Moreover, I believe that H.R. 1427 includes provisions that would enhance the supervisory and enforcement authority of the new agency over the powers the Finance Board has under current law. For example, the Finance Board's enforcement powers are conferred by Section 2B of the Bank Act, which generally incorporates by reference the enforcement powers that Congress has conferred on OFHEO. In other words, the enforcement powers that the Finance Board has today are, with only minor exceptions, derived from the OFHEO statute. To the extent that the OFHEO statute is amended to enhance its enforcement powers, the new agency would have somewhat greater powers than the Finance Board has today. In addition, H.R. 1427 would give the new regulatory agency enhanced conservatorship powers and detailed receivership powers (both of which would apply to the FHLBanks, as well as Fannie Mae and Freddie Mac), which would improve upon the existing authority that the Finance Board has to liquidate or reorganize an FHLBank.

In addition, I do not believe that any existing statute is sufficient to accommodate the oversight of both the FHLBanks and the Enterprises. The Bank Act, which was enacted in 1932, is specific to the Federal Home Loan Bank System, and the Housing Act is specific to the oversight of Fannie Mae and Freddie Mac. Those statutory differences reflect fundamental differences in the structure and operation of the three housing GSEs. For example, the FHLBanks are member-owned cooperatives, whereas Fannie Mae and Freddie Mac are shareholder owned entities whose stocks are traded in the capital markets. That difference manifests itself in different capital structures, different board structures, and different orientations toward shareholder expectations and product pricing. Further, the principal business of the FHLBanks is secured lending to their members, whereas the principal business of Fannie Mae and Freddie Mac (Enterprises) is the securitization of mortgage loans.

A single unified housing GSE regulator would be a more efficient and effective regulator. As I stated in my prepared testimony, what is important is that the new regulator have the ability to fund itself through assessments and be out of the appropriations process; it should have the ability to place a GSE into receivership or conservatorship; it should have the authority to approve new and existing business activities; and it should have the power to set and adjust minimum capital standards. All of these matters can be accomplished by legislation that recognizes the differences between the FHLBanks and the Enterprises. In so doing, the Congress will assure that the important distinctions between the FHLBanks and the Enterprises are preserved.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CARPER FROM RONALD A. ROSENFELD

Q.1. The Federal Home Loan Bank System currently holds $88 billion in private-label MBS and only $4 billion in retained earnings. Fifty-eight of these securities are on negative watch. Given market conditions, is it possible that all or most of the System's retained earnings could be used to write down the private-label MBS?

A.1. The FHLBanks own more than 1,650 private-label mortgage-backed securities (MBS), so it is difficult to generalize about potential losses. Deal structures, including credit support structures, subordination, and pool composition are key determinants of potential losses. We monitor the FHLBanks' private-label MBS portfolios and are working to ensure that the FHLBanks maintain retained earnings at appropriate levels.

As of February 19, 2008, the FHLBanks held 24 downgraded private-label MBS and 53 private-label MBS under negative watch by one or more rating agencies. The securities that have been downgraded or placed on negative watch represent approximately two percent of the FHLBanks' private-label MBS. The remainder of the FHLBanks' MBS is currently rated triple-A with a stable outlook. However, given the volatility in this market, the ratings of these securities could change.

In general, the FHLBanks purchase triple-A "tranches" of private-label MBS. The performance of a particular tranche depends on the performance of the underlying loans and the structure of the particular security. The structure of a security dictates how the cash flows are prioritized among the security's tranches. The problems in the private-label MBS market are serious, but the problems do not affect all securities the same way. For example, losses to an investor would be unlikely if the underlying pool of mortgages is experiencing low delinquencies or has very high levels of credit support.

While many private-label MBS are thought to have a market value below their book value, specific accounting rules govern whether unrealized losses need to be recognized through earnings. The overwhelming majority of the FHLBanks' MBS are in held-to-maturity accounts. Accounting rules require losses to be recognized on such assets when the losses are deemed to be "other than temporary." Factors bearing on whether a loss is other than temporary include, among other things:

- The length of the time and the extent to which the market value has been less than cost;
- The financial condition and near-term prospects of the issuer, including any specific events which may influence the oper-

ations of the issuer, such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; or

- The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

If the FHLBank determines that an MBS in a held-to-maturity account is likely to recover its market value losses over time, and if the FHLBank has both the intent and ability to hold that security to maturity, then it need not record a loss.

Q.2. What are you doing about this and when can we expect the Finance Board to issue a proposed rule on retained earnings?

A.2. In August 2003, the Office of Supervision issued Advisory Bulletin 03–08 that called on each FHLBank to assess the adequacy of its retained earnings in a systematic fashion. This guidance was a part of a continuing supervisory focus on the adequacy of retained earnings. At the end of June 2003, retained earnings were $746 million or 0.09 percent of assets. By the end of 2007, retained earnings had increased to $3.7 billion or 0.29 percent of assets.

We expect the FHLBanks to continually assess the adequacy of their retained earnings in light of market conditions and adjust their retained earnings accordingly. We shortly will be giving instructions to each FHLBank to prepare a substantive analysis of the credit risk exposure stemming from MBS. We will expect them to prepare and submit that analysis to us within 30 days. We will then consider these submissions when we determine the adequacy of each FHLBank's retained earnings.

Although the Finance Board, in 2006, issued a proposed rule governing the minimum amount of retained earnings each FHLBank should have, we deferred any action on the proposed rule. A revised retained earnings proposed rule is not currently under active consideration by the Finance Board.

Q.3. Also can you provide this committee with a list of the downgraded securities?

A.3. The MBS holdings of individual FHLBanks are obtained as part of the supervisory process and are confidential bank supervisory information. I can, however, provide an overview of the downgraded securities in the FHLBanks' MBS portfolios. As of February 19, 2008, the FHLBanks held:

- 14 MBS that had been downgraded to single-A, from triple-A, with a book value of $88.8 million; of these, 10 securities with a book value of $16.8 million remain on negative watch;
- 10 MBS that had been downgraded to double-A with a book value of $413.9 million; of these, 8 securities with a book value of $373.9 million remain on negative watch; and
- 53 MBS securities rated triple-A with a book value of $1.2 billion, were placed under negative watch by one or more rating agencies.

The securities that have been downgraded and/or that are on negative watch constitute two percent of the FHLBanks' private-label MBS holdings. All their remaining private-label MBS are currently rated triple-A, and are not on negative watch. However, given the volatility in this market, the ratings of these securities could change.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM RONALD A. ROSENFELD

One of the areas that I believe needs more debate and vetting is the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund. Fannie and Freddie have affordable housing goals, the Federal Home Loan Banks have an affordable housing program, and the House passed GSE reform legislation would establish a new housing fund with goals. The most recent GSE reform legislation that passed the Senate Banking Committee did not have a housing fund.

Q.1. What are the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund like the House approach?

A.1. Affordable housing goals, the Affordable Housing Program (AHP), and an affordable housing fund provide alternative mechanisms for addressing affordable housing problems and needs. The affordable housing goals applicable to Fannie Mae and Freddie Mac establish targets for their purchases of mortgages in three categories: low- and moderate-income households; housing located in central cities, rural areas, or other underserved areas; and a special affordable category covering low-income households in low-income areas or very low-income households. The AHP requires that each FHLBank use 10 percent of its net income to operate an affordable housing program. The proposed affordable housing fund would require Fannie Mae and Freddie Mac to contribute annually an amount equal to 1.2 basis points of their prior year's total mortgage portfolios, to be allocated by the HUD Secretary to states and Indian tribes for affordable owner-occupied and rental housing, and for targeted economic and community development. The first two approaches, affordable housing goals and the AHP, have operated for well over a decade. The proposed affordable housing fund would be new and includes some features analogous to those of the AHP, such as the contribution of earnings to fund the subsidy. As Chairman of the Federal Housing Finance Board, I am most familiar with the AHP and can best provide insights on the operation and characteristics of this program.

The AHP subsidizes the cost of owner-occupied housing for individuals and families with incomes at or below 80 percent of the area median income (AMI), and rental housing in which at least 20 percent of the units are reserved for households with incomes at or below 50 percent of AMI. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an advance. Each FHLBank funds its own AHP annually by contributing 10 percent of its previous year's net income after the Resolution Funding Corporation payment. In 2007, the 12 FHLBanks contributed a combined $295 million to the AHP; since 1990, the FHLBanks have contributed about $3.2 billion to assist eligible affordable owner-occupied and rental housing.

The FHLBanks award AHP funds through a competitive application program and a homeownership set-aside program. In the competitive program, members submit applications on behalf of one or more sponsors of eligible housing projects. Projects must meet certain eligibility requirements and score successfully in order to obtain funding. Under the homeownership set-aside program, an FHLBank may allocate up to the greater of $4.5 million or 35 percent of its AHP funds each year to assist low- and moderate-income households purchase or rehabilitate homes, provided that at least one-third of the FHLBank's homeownership set-aside allocation is made available to assist first-time homebuyers. Members obtain the AHP set-aside funds from the FHLBank and then use them as grants to eligible households. Homeownership set-aside funds may be used for down payment, closing cost, counseling or rehabilitation assistance in connection with the household's purchase or rehabilitation of an owner-occupied unit. Each FHLBank sets its own maximum grant amount, which may not exceed $15,000 per household.

The structure and operation of the AHP exhibit a number of strengths on which I elaborate in my response to the question below. I believe that key lessons we have learned are that program flexibility and local decision-making are preferable to a prescriptive, centralized Washington-defined and driven program, but that a strong supervisory foundation should accompany program flexibility. The Bank Act has provided flexibility to the Finance Board as regulator to adjust the AHP as conditions warranted; the Finance Board has amended the AHP regulation a number of times, including substantively in 1998 and 2006. The Finance Board has strengthened its AHP examination program and completed the development of a modernized AHP database to provide enhanced measurement of program outcomes.

Q.2. If we go down the track of creating a housing program or housing trust fund for Fannie and Freddie, what is the appropriate amount of resources that should be spent, who should allocate the funds, and how should the funds be spent?

A.2. The AHP offers one model of a successful program to support affordable housing. The AHP's design ensures that the funds are used for eligible purposes to meet the statutory requirement that the preponderance of the subsidy directly benefits very low, low- and moderate-income households. In the case of the AHP, the FHLBanks bear the administrative costs of the program as well. The flexibility of the program allows it to respond to local housing conditions and needs, adapt to evolving market conditions and capitalize on innovations in affordable housing finance. Program decision-making and eligibility requirements are transparent and not subject to political or corporate influence in the use and distribution of funds.

The following seven program features contribute to the efficient and effective use of program funds and help to protect the AHP's integrity:

Basic Eligibility Requirements—Regulatory and statutory eligibility requirements are clear and public. Under the competitive program, any rental or homeownership project that meets the eligibility criteria may apply regardless of corporate or political affiliation. Under the homeownership set-aside program, households that meet the eligibility requirement may apply to a member lender for down payment, closing cost or rehabilitation assistance, typically on a first-come-first-served basis.

Competitive Scoring System—The scoring system is transparent and accessible to the public. Applicants receive points based on the extent to which the projects meet defined, largely objective criteria. In each funding round, the FHLBanks must fund the highest scoring applications in the order of their ranking by points until the available amount of subsidy is exhausted. Applications are not judged on any merits outside of the scoring system, and "lobbying" for certain applications or projects has no effect on the scoring outcome or the decision to fund the project.

Timely Awarding of Funds—Each FHLBank's annual contribution of AHP subsidies must be used by or committed to eligible projects within that year. Consequently, the FHLBanks announce the successful applications within a few months of receiving the applications. Funding decisions are clear, quick, and public.

Recapture of Misused or Unused AHP Subsidies—If a project sponsor or household receives AHP subsidy that it does not use for the duration of the affordability retention period or does not use in accordance with the AHP requirements, the FHLBank must recapture the amount of AHP subsidy. Recapture ensures that AHP funds that are not used properly are repaid to the AHP and used for subsequent projects and are not "lost" to the program. This liability for recapture is a financial incentive for the FHLBanks to operate the program in strict conformance with the requirements of the statute and regulation.

Conflicts of Interest Policies—The FHLBanks establish and adhere to conflicts of interest policies that are applicable to FHLBank directors, to management and staff, to FHLBank member lenders, and to Advisory Council members.

Oversight by a Public Advisory Council—Each FHLBank has an Advisory Council comprising housing and community investment practitioners and experts. These councils advise their respective FHLBanks on affordable housing needs in the district and the use of AHP subsidies, set and review scoring criteria, and evaluate the outcomes of funding rounds.

Oversight by the Federal Regulator—The Federal Housing Finance Board conducts examinations of the FHLBanks' AHPs. These examinations cover both the FHLBanks' compliance with the operational requirements of the AHP, and the FHLBanks' oversight of projects' compliance with the low-or-moderate-income targeting and affordability requirements of the program.

Q.3. Does it make sense to have both housing goals and a housing program for Fannie and Freddie?

A.3. The existing housing goals and the affordable housing fund proposed in the House-approved GSE reform legislation operate in different ways, may reach different beneficiary groups or fulfill different purposes, and need not be mutually exclusive. The housing goals focus on the operation of the basic business of the enterprises—purchasing mortgages on the secondary market—and provide benefits indirectly. The 1992 legislation initially establishing the affordable housing goals for the Enterprises referred to their ". . . affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes, while maintaining a strong financial condition and a reasonable economic return." One effect of the housing goals could be to extend the reach of the private market to lower income groups while also contributing positively to the bottom line of the enterprises. An affordable housing fund or program would use funds earned by the Enterprises to provide an explicit subsidy to affordable housing projects or initiatives that meet established criteria. The specific focus for any funding cycle could change to reflect current market conditions and needs and would not necessarily be connected to the secondary market.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM RICHARD F. SYRON

One of the areas that I believe needs more debate and vetting is the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund. Fannie and Freddie have affordable housing goals, the Federal Home Loan Banks have an affordable housing program, and the House passed GSE reform legislation would establish a new housing fund with goals. The most recent GSE reform legislation that passed the Senate Banking Committee did not have a housing fund

Q.1. What are the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund like the House approach?

A.1. There are many factors that impact the availability of affordable housing including, for example, the availability of mortgage credit and the physical supply of housing. There are also different policy tools that are designed to address those factors. As discussed below, housing goals, a duty to serve, and an AHF have varying strengths and weaknesses in their ability to address affordable housing needs.

HOUSING GOALS

A key strength of the affordable housing goals is that they help ensure the availability of mortgage credit to low- and moderate-income families and families living in underserved communities by requiring that certain percentages of the enterprises' mortgage purchases finance mortgages made to these families, or finance affordable rental housing. Housing goals thus leverage the ability of the enterprises to provide liquidity to the secondary mortgage market, and also produce a measurable policy outcome.

However, goals and subgoals set in excess of what the primary market originates should be avoided to prevent adverse unintended consequences, such as over-extension of mortgage credit that can in turn result in increased borrower foreclosures and credit losses. In fact, a disproportionate share of our credit losses is attributable to loans that qualify for one of HUD's affordable housing goals. These loans incur losses approximately two times the rate of non-goal qualifying loans.

To be effective, the GSE regulator must consider prevailing market conditions in making a determination with respect to goals achievement and must have responsibility to recalibrate the goals in response to changes in market conditions. Finally, the number of goals and subgoals should be limited; when market conditions are volatile and, as the number of goals increase, so too does the likelihood that all goals and subgoals are not concurrently feasible. A mix of feasible and infeasible goals that are equally enforceable will create unintended market distortions.

A key weakness of the housing goals is that they can only address the availability of mortgage credit and not other issues that are important to enhancing sustainable home ownership, such as the supply of affordable housing.

DUTY TO SERVE

In addition to numerical goals, the GSE reform bill passed by the House of Representatives in May 2007, H.R. 1427, and the bill introduced by Senator Reed in November 2007, S. 2391, would create an explicit duty to serve underserved markets that would require the enterprises to increase investments in products and develop credit policies that promote lending in certain affordable housing areas that policymakers designate as underserved by the market. The duty to serve also would be fully enforceable in the same manner as the housing goals.

Given the imprecise nature of a duty to serve, we believe that the regulator should have flexibility to assess an enterprise's compliance with a duty to serve and that enforcement should not be punitive. For example, the regulator should not be required to automatically subject an enterprise to the full panoply of cease-and-desist and civil money penalty enforcement tools for failure to achieve a single aspect of the duty to serve.

Finally, any duty to serve must be limited in number, duration, and total financial burden to ensure that the duty does not impair the enterprises' additional mission responsibilities to provide liquidity and stability to the market or impair the enterprises' safety and soundness. Unless the regulator must review these underserved designations periodically, there is a significant risk of imposing a continuing legal duty on the enterprises even after the policy basis for such a designation ceases to exist.

An alternative means to focus the enterprises' attention on certain housing markets, is through establishing a bonus points incentive system, within, not in addition to, the numerical goals framework.

AFFORDABLE HOUSING FUND

A principal strength of an AHF is that it directly increases the supply of affordable housing by subsidizing the construction or preservation of such housing. Because an AHF targets the construction and preservation of affordable housing and mandates spending funds for such purposes, it helps ensure that affordable housing will be built or preserved. If the objectives and management of an AHF are sufficiently flexible, direct subsidies can also be combined with other federal, local or private money to leverage the effect of the subsidies and provide an even greater supply of affordable housing. An AHF analogous to the affordable housing program (AHP) that the FHLBs must establish, could encourage investments and innovations that complements the core affordable responsibilities of the enterprises.

A principal weakness of the AHF model with respect to the enterprises is that it does not leverage our expertise in providing liquidity and stability to the residential mortgage market. The enterprises are designed to provide a secondary market in support of mortgage finance, not provide direct subsidies to particular forms of affordable housing.

We believe that the establishment of an AHF should not be viewed in isolation, but rather in the context of our overall affordable housing mission and other regulatory requirements. With this perspective in mind, if GSE reform legislation that includes an AHF is crafted appropriately, it could be an effective means through which we advance our affordable housing mission.

Q.2. If we go down the track of creating a housing program or housing trust fund for Fannie and Freddie, what is the appropriate amount of resources that should be spent, who should allocate the funds, and how should the funds be spent?

A.2. Freddie Mac believes that if the enterprises are required to fund an AHF, the enterprises' contributions must be tied to profitability, rather than based on a poll tax on each enterprises' total portfolio, as in H.R. 1427, or new mortgage purchases, as in S. 2391. In this way, the success of the fund would be more closely tied to the success of the enterprises. This type of alignment has been successful for the FHLBs' AHP, on which the AHF is modeled.

There are sound policy reasons for linking AHF contributions to profitability. Congress created the enterprises to harness private capital to bring liquidity, stability and affordability to the nation's housing finance system in all economic environments—a vital role, as current market conditions demonstrate. When markets are calm and business is profitable, the enterprises can make a reasonable AHF contribution without significant damage to the residential mortgage market. However, a contribution formula based on volume of business would not adequately take into account adverse economic times—when the enterprises are most needed. For example, had either H.R. 1427 or S. 2391 been in effect in 2007, the enterprises' 2008 AHF contribution would have been about $550 million. The resulting decrease in the enterprises' capital bases would remove about $17 billion of liquidity from the mortgage finance system in 2008.

In the event the enterprises continue to be subject to numerical housing goals and are also required to fund an AHF, we believe that allocations to the AHF should be limited in recognition of the financial impact of numerical goals.

If an AHF is created by Congress, we support the approach taken in H.R. 1427 and S. 2391 whereby the enterprises' regulator would be responsible for the AHF's administration. The enterprises do not possess the requisite expertise for making grants on a large-scale and for monitoring compliance with the terms under which funds would be provided to housing and community organizations.

Q.3. Does it make sense to have both housing goals and a housing program for Fannie and Freddie?

A.3. We do not believe the enterprises need both housing goals and a housing program to help meet the affordable housing needs of low- and moderate-income families and families living in underserved communities that the housing goals are intended to help. In the event legislation includes both provisions, we would urge the Congress to take into account the full impact of any expansion of the enterprises' affordable housing obligations including multiple and potentially overlapping housing goals and subgoals, creation of an enforceable duty to serve, and establishment of an AHF.

In summary, it is important that the enterprises have objective affordable housing goals to which they are held accountable. However, we must ensure that we do not end up with too many goals that are too confusing and with too much potential to have perverse, if unintended consequences.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM DANIEL H. MUDD

One of the areas that I believe needs more debate and vetting is the strengths and weaknesses between affordable housing goals, affordable housing programs, and an affordable housing fund. Fannie and Freddie have affordable housing goals, the Federal Home Loan Banks have an affordable housing program, and the House-passed GSE reform legislation would establish a new housing fund with goals. The most recent GSE reform legislation that passed the Senate Banking Committee did not have a housing fund.

Q.1. What are the strengths and weaknesses between the affordable housing goals, affordable housing programs, and an affordable housing fund like the House approach?

A.1. To achieve the affordable housing goals, Fannie Mae has devoted more than half of its business to serving underserved families and communities. At the very minimum, the housing goals have helped to ensure that the GSEs' effort and performance in serving the housing finance needs of low- and moderate-income households and underserved areas lined up with the performance of the market. More than that, Fannie Mae's affordable housing initiatives—including our voluntary minority lending stretch goals—may well have helped to transform the market. Clearly, more needs to be done because too many families and communities remain underserved by housing finance, and the current housing correction is hitting underserved families harder and threatening the nation's progress. But we believe the objective of the affordable housing goals has been achieved, as the GSE commitment—and achievement—of the goals has promoted significant innovation in sustainable affordable housing finance and helped to advance homeownership.

Along the way, a hidden strength of the GSEs' regulatory regime was the way in which the goals were integrated into the business practices of the two enterprises. The goals provided their intended incentives; they encouraged the GSEs to harness their human capital, technology, standardization, risk management expertise, product development and innovation, and capital market access on behalf of the housing finance needs of low- and moderate-income families and underserved areas. The housing goals encouraged the GSEs to use private-sector skills—the skills needed to succeed as a for-profit, shareholder-owned company competing in a highly-competitive global market—to serve the targeted populations.

The affordable housing goals are an important part of our mission, and Fannie Mae has worked hard to achieve the goals. However, we believe that any new legislation should address several weaknesses in the current goals regime.

First, the goals have now exceeded the available market opportunities presented to the GSEs. The current housing and mortgage market correction, tightened lending standards and collapse of lending to borrowers with imperfect credit has vastly reduced the supply of loans in the market that meet current HUD goals. We recognize that increasing the goals has prodded GSEs to do more to meet the nation's affordable housing needs and expand homeownership to underserved families and communities, and to play a leadership role in the market by creating a source of capital for loans that might not otherwise have been made. We embrace—and pursue—those objectives in our business activities every day. But when the market for goals-related loans falls below the goal requirements, in spite of our best efforts to promote more affordable lending, then the goals can encourage market-distorting activities.

In particular, when the goals exceed actual market opportunities, meeting them requires the GSEs to pay a premium over market prices—often a substantial premium—for loans that meet goals requirements. We are concerned that may promote unsustainable lending. One alternative would be to reduce our participation in loans that do not meet the housing goals, including lending to middle-class families, thus reducing the denominator of the goals calculation. That, of course, would contradict the liquidity mission for which the GSEs were chartered by Congress.

Second, over time, managing compliance with the goals has become increasingly complex. In the 2004 rule-making, HUD added three home purchase subgoals to the existing three goals and an existing multifamily special affordable subgoal. This new layer of complexity has added to the administrative challenges of measuring, tracking, and reporting goals performance and complying with other aspects of the regulations. The complexity has also created situations where the goals and subgoals can conflict with one another. For example, because the goals and subgoals are measured as a percent of our total business, efforts to close a gap in our performance on the low- and moderate-income subgoal would make it harder to meet the special affordable housing subgoal—unless the purchased loan met both subgoals simultaneously.

Third, the goals are not aligned with the affordable housing requirements of other regulated financial institutions that participate in the mortgage market—those that have such requirements; many do not. For example, the Community Reinvestment Act, which applies to banks and thrifts, has rules and incentives that differ significantly from the GSE affordable-housing goals. Likewise, Fannie Mae and Freddie Mac must meet affordable housing goals, while the Federal Home Loan Banks, also GSEs, are required only to operate an Affordable Housing Program (AHP) that makes grants in support of affordable housing developments and first-time homebuyer programs. H.R. 1427 contemplates that Fannie Mae and Freddie Mac would also be required to contribute to a program similar to AHP (though unlike the FHLB program, H.R. 1427 would not permit the GSEs to manage the fund). Fannie Mae would encourage that legislation to improve GSE affordable lending requirements align the goals and incentives of all the players in the primary and secondary mortgage market.

Fourth, recent legislative proposals have included a provision that would impose a new duty on the GSEs to serve certain underserved markets by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for mortgage financing for these markets. Specifically, the GSE would be required to lead the industry in developing loan products and flexible underwriting guidelines to facilitate a secondary market in at least three specified markets—manufactured housing, affordable housing preservation, and rural housing. This new duty to serve underserved markets would be in addition to the GSEs' continuing commitment to meet affordable housing goals and the GSEs' new commitment to contribute to an affordable housing fund.

Fannie Mae stands ready to address the specific housing needs identified by Congress as part of a new mission framework. However, we are concerned that if this new requirement is crafted as an enforceable subgoal and defined in a quantitative manner, it would create a burdensome inefficiency in our business. We would support Duties to Serve that were articulated and enforced in a manner that is flexible and consistent with market opportunities, encouraged the GSEs to lead the industry with both quantitative and qualitative contributions, and that did not impose any additional unintended costs on our business to meet these requirements.

Finally, regarding the strengths of affordable housing programs and an affordable housing fund, we believe they appropriately provide critical subsidy dollars to the affordable lending equation. Absent some form of subsidy, the private sector GSE or otherwise cannot reliably finance housing that is affordable to the very lowest-income families.

However, we would offer that a principal weakness currently in the nation's housing programs is that affordable housing developers need to seek subsidies from multiple sources in order to make their projects succeed. The layering of subsidies and the complexity of meeting different rules and program requirements in the development of affordable housing increases "soft" costs that eat up too much of the scarce subsidy dollars. Certainly, the consideration of a new federal program financed by GSE dollars would need to address—or at least avoid exacerbating this problem.

Below is a brief description of how the housing goals work today.

- By statute, a percentage of Fannie Mae's mortgage purchases every year must serve targeted segments of the home-buying public: low- and moderate-income families, families with very low incomes, and families living in underserved communities. The Department of Housing and Urban Development (HUD) sets those goals by regulation. HUD's current regulations, promulgated in 2004, increased the housing goals levels for 2005–2008, increased the special affordable multifamily subgoal, and created new home purchase subgoals.
- For 2007, the annual housing goals were as follows: 55 percent of the dwelling units financed by Fannie Mae's mortgage purchases must be affordable to low- and moderate-income families (families with incomes at or below the area median income); 25 percent must be affordable to very low-income families (families with incomes less than 60 percent of area median income) or low-income families living in low-income areas; and 38 percent must be affordable to families living in underserved areas.
- In addition, the multifamily special affordable subgoal sets a minimum dollar volume of qualifying multifamily mortgage purchases that Fannie Mae must meet annually. The most recent goal was set at $5.49 billion.
- The home purchase subgoals are expressed as percentages of the total number of mortgages purchased (rather than dwelling units financed by mortgage purchases) by Fannie Mae that finance the purchase (not refinance) of single-family, owner-occupied properties located in metropolitan areas. For 2007, the subgoals were as follows: 47 percent of Fannie Mae's purchases of home purchase mortgages on single-family, owner-occupied properties in metropolitan areas must serve low- and moderate-income families, 18 percent must serve very low-income families or low-income families living in low-income areas, and 33 percent must serve families living in underserved areas.

Q.2. If we go down the track of creating a housing program or housing trust fund for Fannie and Freddie, what is the appropriate amount of resources that should be spent, who should allocate the funds, and how should the funds be spent?

A.2. Fannie Mae supports the creation of an affordable housing fund calculated from net income that is aligned with the objectives of the affordable housing goals and strengthens our public mission. We believe the most effective approach to such a fund would be to link our contribution to our net income, rather than the size of our book of business or new loan acquisitions. In addition, we believe there should be provisions that permit a GSE to suspend payments to the fund if the payments would risk a depletion of capital to a level that is inconsistent with the GSEs' established capital management practices or—since the contribution is based on net income—if we were not able to achieve a profit in the previous year.

Fannie Mae has also stated that we believe the GSEs should manage the affordable housing fund, rather than transferring company resources to the government or a third party to administer the funds. While on the face of it, enabling the GSEs simply to "write a check" would free us from the administrative costs and requirement of managing the fund, we believe the most efficient and effective use of the funds would be to harness them to enhance our ongoing affordable housing efforts including, but not limited to, the goals. In particular, if managed by the GSEs, the affordable housing funds would permit us to marry this subsidy with our private capital investments to more effectively serve underserved families and communities. This approach provides a unique opportunity to promote affordable housing efforts that are scalable and replicable, consistent with the GSE business model. GSE management of an Affordable Housing Fund would permit—and encourage—us to work directly with, and assist, the network of state and local affordable housing partners we have built over the years of community investment work. We believe the GSEs should manage the fund in regular consultation with Congress and our regulator, including filing an annual plan and report on our efforts. We should manage the fund, and we should be held accountable for the results.

Conversely, we are concerned that if a separate affordable housing program is created with GSE contributions but not GSE management, the result would be another federal program—in essence, yet another layer of federal affordable housing subsidies with its own set of rules. The new program would certainly provide more resources for affordable housing, but would also increase transaction and other "soft costs" that would dilute the impact of the new dollars.

Q.3. Does it make sense to have both housing goals and a housing program for Fannie and Freddie?

A.3. This is an important issue because of the potential for the two combined—meeting the affordable housing goals and supporting an affordable housing fund—to impose an inordinate and unsustainable cost to the GSEs, ultimately undermining their ability to serve the market as a private enterprise. If Congress does wish to retain both requirements, Fannie Mae believes that housing goals requirements and an affordable housing program could exist side-by-side under these conditions:

- The combined cost of the affordable housing goals and the affordable housing program does not hinder the ability of the GSEs to succeed as privately-owned companies in a highly competitive market, or impede their core missions of providing liquidity and stability to the broader housing finance system;
- The housing goals requirements are consistent with the realistic market opportunities for the secondary market, such that the goals do not impose inordinate costs on the companies in addition to the amount required to support the affordable housing fund; and

- The requirements are integrated: That is, the GSEs should be able to apply the affordable housing fund resources to help the companies to address the other mission requirements established by Congress in the legislation.

Ultimately, we believe that in establishing GSE affordable housing requirements—housing goals and/or housing fund, or otherwise—it is important to recognize that we fulfill our public charters through private enterprise. That means permitting the enterprises to harness and pursue private sector efficiencies, strategies, innovations. It also means recognizing that market forces are an important consideration. Finally, it means bearing in mind the trade-offs that are inherent in the use of private capital in lieu of public funding to achieve a national policy goal. To be specific, the requirements of private enterprise include marshaling, conserving and deploying capital wisely; maintaining a high degree of financial safety and soundness; managing business and financial risk; being competitive; and being profitable in order to provide a return to shareholders who finance the enterprise.

Fannie Mae is deeply committed to our affordable housing mission, and we recognize that fulfilling that mission requires us to operate as a successful, ongoing enterprise. We believe that Congress has a unique opportunity to modernize our affordable housing requirements for the betterment of both the GSEs and low- and moderate-income homeowners and renters. We look forward to working with you to achieve that goal, and thank you for the opportunity to share our views.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Federal Housing Finance Board
Office of the Board of Directors

STATEMENT FOR THE RECORD

OF

GEOFFREY S. BACINO
DIRECTOR, FEDERAL HOUSING FINANCE BOARD

And

Dr. ALLAN I. MENDELOWITZ
DIRECTOR, FEDERAL HOUSING FINANCE BOARD

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

FEBRUARY 07, 2008

GSE REGULATORY REFORM - A DIFFERENT POINT OF VIEW

We appreciate this opportunity to present our views regarding proposed reforms of the regulation of the federal housing GSEs.

We have served on the Federal Housing Finance Board (FHFB) for a combined total of almost nine years and have participated in developing FHFB policies and regulations of the Federal Home Loan Bank System. Participation in those decisions was instructive and helped shape our views on the importance of the FHFB and what is needed in the future.

Our primary long run objective is to continue the progress we are making in turning the FHFB into a "world class" regulator of the Federal Home Loan Bank System - a regulator responsible for the safety and soundness, as well as the mission, of the System. In his testimony, FHFB Chairman Ronald Rosenfeld briefed you on the extraordinary efforts of the Federal Home Loan Banks to mitigate the impact of the freezing up of financial markets, so we will not repeat those statistics. However, we do note that the FHFB's strong regulatory oversight of the Federal Home Loan Banks was an important factor in the ability of the Federal Home Loan Bank System to perform that critical role. As we have worked together on these challenging issues, we should note that it has been a pleasure to work with the Chairman and our other colleagues on the Board. We each bring different experiences, expertise, and regulatory philosophies to our current responsibilities. However, it is because of those differences that we are able to do a more thoughtful and effective job of regulating the Federal Home Loan Banks. It is these experiences that make us optimistic about the future of the FHFB and the Federal Home Loan Bank regulatory system, particularly since the Federal Home Loan Banks have served as the primary federal agency responding to the current crisis in the financial markets. We have carefully and successfully balanced safety and soundness with our housing finance mandate in order to prevent the meltdown of credit markets in August of 2007 from turning into an even worse financial market crisis.

On the matter of GSE regulatory reform, each one of us on the FHFB holds his or her own views. No single member of the Board of Directors can speak for the agency. Hence, our views on GSE reform are our personal views.

Stated simply, we oppose folding the regulation of the Federal Home Loan Banks into a single GSE regulator. The central issues at hand relate to the statutory powers of OFHEO, the regulator of Fannie Mae and Freddie Mac. Little if anything in the debate has any relevance to the Federal Home Loan Banks or FHFB.

We see few if any potential benefits for the regulation of the Federal Home Loan Banks, from such a change, and we see significant downside risk. The regulatory regime and the activities of the Federal Home Loan Banks have little in common with the regulatory regime and activities of Fannie Mae and Freddie Mac, currently regulated by OFHEO. Because the regulatory issues and challenges are so different (and the issues surrounding Fannie Mae and Freddie Mac are so much more visible), we fear that the quality of the regulatory oversight of the Federal Home Loan Banks' safety and soundness would suffer and the System's mission could be substantially diminished.

We take as our starting point the following:

- We are firm believers in the mission of the Federal Home Loan Bank System – to provide needed liquidity and support housing finance;
- Since the 1930's, the Federal Home Loan Bank System has ably served as an essential element of the nation's housing finance system and as a key institution in implementing community and economic development goals;
- We do not agree with those who claim that because of changes in the private capital markets, the Federal Home Loan Bank System is now obsolete; and
- We believe the most effective way to assure the safety and soundness and robust mission of the FHLBank System is to maintain the FHFB as the independent regulator, led by a five-member Board of Directors.

THE ADMINISTRATION'S GSE REFORM PROPOSAL

Central to the Administration's proposal is the strengthening of the legal authorities of the regulator of Fannie Mae and Freddie Mac. Furthermore, the administration proposes to consolidate the supervision of Fannie Mae, Freddie Mac and Federal Home Loan Banks into a "new" regulatory body headed by a single administrator, rather than a multi-person financial regulatory board, such as the Securities Exchange Commission (SEC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Federal Reserve Board (FRB) and the FHFB. Would this really be a more desirable regulatory structure for the financial institutions they regulate? Would a single regulator overseeing all of the housing GSEs be a preferable regulatory structure? We think not.

Having served on multi-person federal financial regulatory agencies, we believe that better policy decisions result from the interplay of regulators with different backgrounds and perspectives. The designers of FRB, the SEC, the NCUA, to mention only a few examples, understood the need for this diversity of power and thought.

In many presentations promoting the Administration's proposed GSE bill, OFHEO makes five basic arguments in support of their version of a GSE reform plan. We would like to comment on those five arguments and demonstrate that they are largely irrelevant when applied to the regulation of Federal Home Loan Banks.

1. **<u>Bank-Regulator-Like Powers</u>**

The first argument that has been made is that the new housing GSE regulator needs "bank-regulator-like powers." OFHEO, or its successor, claims to need independent litigation authority and receivership authority to effectively regulate Freddie Mac and Fannie Mae.

The FHFB already has independent litigation authority and expansive regulatory powers to reorganize and liquidate a Federal Home Loan Bank. No reform legislation is essential in order to arm the current Federal Home Loan Bank regulator with additional powers.

2. **<u>Independence</u>**

OFHEO contends that "regulatory independence for the GSE regulator must be strengthened". However, the FHFB is independent of the political control of any Administration.

OFHEO argues that OFHEO or its successor GSE regulator should be freed from the congressional budget process in order to assure independence. However, FHFB already has independent budget authority and there is no need for legislation to assure the policy or budget independence of the FHFB.

Finally, with no evidence or discussion, OFHEO asserts that "greater regulatory muscle and independence will be provided by combining the agency with the FHFB, the regulator of the Federal Home Loan Banks."

The FHFB already has the strength and the independence to perform its regulatory functions adequately and efficiently. The FHFB does not need new legislation to achieve these regulatory objectives. Furthermore, we do not see how eliminating the FHFB would provide OFHEO with independence and muscle that it cannot realize on its own.

3. **Mission and New Product Authority**

Third, OFHEO argues that since the current authority over the mission and products offered by Freddie Mac and Fannie Mae is vested in HUD, OFHEO is left in the difficult position "of considering only safety and soundness elements of activities that could be in violation of an Enterprise's charter." The FHFB already exercises authority over the Federal Home Loan Banks' mission and new product offerings. Hence, no new authority is needed by the regulator of the Federal Home Loan Banks.

4. **Flexible Capital Requirements**

OFHEO argues that "flexible capital requirements are needed to strengthen regulation of the Enterprises" and concludes that OFHEO's risk-based capital requirements have been constrained by requirements contained in the 1992 statute.

While OFEO may need legislation on this matter, the FHFB does not. The FHFB already has sufficient authority to adjust capital requirements for Federal Home Loan Banks to meet any new risk. In fact, the FHFB has had no difficulty in imposing additional capital requirements and dividend limits on the banks we regulate, something OFHEO says that it is unable to do. Hence, on this issue, there is again no reason to include the Federal Home Loan Bank System in what should be an OFHEO reform bill.

5. **Limits on Fannie and Freddie Portfolio Growth and Federal Home Loan Bank Advances**

Finally, OFHEO has argued that its successor should have explicit authority to set portfolio growth limits for Freddie Mac and Fannie Mae. We understand these concerns. But in the face of the current crisis in which the GSE segment of the housing finance market is the only part of the market that continues to function effectively, is this the most important priority at this time? While this is an important policy issue for the Congress to resolve, it is not an issue for the Federal Home Loan Banks.

Placing arbitrary caps on Federal Home Loan Bank lending to member financial institutions makes no sense. The way such lending is capitalized (members must buy the Federal Home Loan Bank stock needed to support their borrowing) and the way in which risk is sharply limited (lending to members is on a fully secured basis) makes any arbitrary caps unnecessary. And, most importantly, if arbitrary caps were placed on the Federal Home Loan Banks advances, the System's critical role as an assured provider of liquidity would cease to be viable.

Again, we have a set of arguments being made for GSE reforms that are irrelevant with regard to the safe and sound operation of the Federal Home Loan Bank System, and potentially very deleterious to the mission of the Federal Home Loan Banks. We fear that policy initiatives of a new combined regulator could suffer from the dangers of false analogies. If portfolio limits were placed on Fannie Mae and Freddie Mac by a new combined regulator, we can see how arbitrary caps on Federal Home Loan Banks lending to their members could be easily adopted in order to assure that all the GSEs were treated equally.

HISTORY OF THE GSE DEBATE

The case to reform the regulation of Fannie Mae and Freddie Mac has gone through a torturous and long public policy debate. It started when these two GSEs were economically and politically very powerful. The critics of these entities came with an assortment of different motivations. They were successful in initiating a debate over the regulation of Fannie Mae and Freddie Mac which highlighted a number of important issues regarding the regulatory powers of OFHEO and potential risks associated with Fannie Mae and Freddie Mac. In doing so, they also set the terms of reference of the debate. As everyone in Washington knows, the side that frames the terms of reference of a public policy debate is ninety percent of the way toward winning the public policy battle.

The debate over the need to reform the regulation of Fannie Mae and Freddie Mac focused on the costs and benefits of these GSEs – as defined by their critics. The primary benefit was identified as one-quarter of a point off the cost of a prime conforming mortgage. This "benefit" was arrived at by comparing the cost of prime conforming mortgages with the cost of high credit quality jumbo mortgages. Twenty-five basis points was the spread between these two types of mortgages before the meltdown of the credit markets this past August. On the cost side, one major cost of the GSEs was defined as the contingent liability to the U.S. Treasury, which was estimated to be several hundred billion dollars. This estimate was repeatedly put forward by critics of the GSEs, notwithstanding the repeated statements by administration spokespersons that there was no such thing as an "implicit guarantee" for GSE debt or MBS. And, hence, there could be no contingent liability. The second major cost put forth by GSE critics was the specter of "systemic risk."

In all of the debate over the need to reform regulation of OFHEO, no one mentioned the most important benefit of the GSEs – assured liquidity for housing finance at appropriate levels. And, in all of the debate, no one bothered to consider that the private sector alternatives to the GSEs presented much greater systemic risk than the GSEs. The 2007 meltdown of U.S. credit markets was the result of the systemic risk posed by unregulated or lightly regulated private sector firms. The government is now faced with determining how to best fix the ensuing financial mess that is pushing the U.S. economy into recession.

DROP THE FHFB FROM ANY FANNIE MAE AND FREDDIE MAC REGULATORY REFORM BILL

By including the Federal Home Loan Bank System in this reform package, the Federal Home Loan Banks, in our view, are being held hostage by those who see the need to reform the regulation and business of the other two housing finance GSEs. There are good arguments for why OFHEO needs additional regulatory authorities. However, those arguments have no bearing on or relevance for the Federal Home Loan Banks and the Federal Housing Finance Board.

At this time of great difficulty in financial markets and housing finance, the Congress should move carefully to try to fix the current crisis, without disturbing those parts of the market and the regulatory structures that are working well. That is why we urge you to drop the Federal Housing Finance Board from any OFHEO /Freddie Mac and Fannie Mae reform bill. This is especially important because, no matter how valuable such a bill may be from the perspective of effective regulation of Freddie Mac and Fannie Mae, regulatory reform itself will make no contribution to repairing the current crisis in financial markets and housing finance. And, unnecessary changes hold the risk of making the situation worse.

REFORMING THE REGULATION OF GOVERNMENT-SPONSORED ENTERPRISES

THURSDAY, MARCH 6, 2008

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room 538, Dirksen Senate Office Building, Hon. Christopher Dodd, chairman of the committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The committee will come to order. I am told that Senator Shelby will be here at some point, but has an Appropriations Committee hearing this morning and so will be a little bit delayed. I see Senator Reed and Senator Corker are here, and I appreciate my colleagues' participation. I want to thank all of our witnesses, as well.

The committee this morning is holding our second hearing on the topic of reforming the regulation of the government-sponsored enterprises. In February, we heard from the Treasury Department and regulators from the two enterprises. Today, we will hear from the Government Accountability Office as well as a host of interested and knowledgeable parties with considerable housing expertise.

As I mentioned at our last hearing, under the very able leadership of Senator Richard Shelby, this committee established a very substantial record on the GSE issue over the course of the previous two Congresses, and I want to reiterate what I have said previously about Senator Shelby and his work, having been a member of those committees, obviously, and how important those hearings were.

This hearing adds, I think, to the significant body of work that we have accumulated on this subject matter, and as I said at the last hearing, the current crisis in the mortgage markets underscores the need to have strong and healthy housing GSEs. The FHA and conforming conventional markets are the only parts of the mortgage market system that in my view are operating effectively today.

Both Fannie Mae and Freddie Mac, each of whom have just recently brought their financial reporting up to date, announced serious losses for 2007. In 2007, Freddie Mac experienced its first ever annual loss, and Fannie announced its first annual loss in over 20 years. Despite these problems, however, and in part because of improved oversight by OFHEO, both of these bodies are doing one of the important jobs for which they were created, and that is maintaining liquidity in the mortgage markets.

Unfortunately, some recent announcements by the enterprises raise questions as to how committed these institutions are to continue to meet this obligation going forward. Both Fannie Mae and Freddie Mac have announced plans to raise costs or limit access to credit in areas that may be in most need of affordable credit. Again, I know I am going to hear about safety and soundness, and that is very, very important, but these institutions were created for unique purposes here, and the fact that we are maybe not addressing some of the underlying areas raises questions in this Senator's mind. These kinds of plans will exacerbate, in my view, the credit cycle rather than mitigate its negative effects. In my view, this is a curious policy for a government-sponsored enterprise to pursue.

In any case, there is broad agreement that we need a strong single regulator for all the housing GSEs with the authority over safety and soundness and mission, with the power to set capital commensurate with the risk, to issue cease and desist orders, to require prompt correction action, and to correct unsafe practices or conditions. We also need a strengthened commitment to housing affordability for low-income families as well as middle-class families, for renters as well as homeowners, and for homeowners at risk of losing their homes because of the terrible lending practices that we have seen over the past several years. It is my hope to move legislation to achieve all of these outcomes as soon as we possibly can.

Before turning to my colleagues, I want to take brief note of the speech given by Federal Reserve Chairman Bernanke earlier this week. Chairman Bernanke has now advocated for the kind of bold action that I and others have been arguing for as needed to address the housing crisis that has spread more broadly to the capital markets, causing significant damage to the rest of our economy. As all of you know, or many of you know, I am drafting legislation to put part of these ideas, a plan in action. There is nothing that is written in marble about these ideas, or concrete, but I commend Chairman Bernanke for recognizing that just assuming market forces can somehow straighten all of this out is probably naive and that we need to step forward with some bolder ideas. I welcome the speech he gave in Florida just a few days ago, and obviously I look forward to working with all of my colleagues here on trying to develop some ideas that we can go forward on.

I am disappointed that we have been unable over the last couple of weeks here to come forward with some ideas that I thought would enjoy pretty broad bipartisan support. I recognize to try and come up with something that may be novel or unique or relatively unique would probably be more than the institution could tolerate in a short amount of time, but my hope is in some of these other areas, we might have been able to move forward. I am still hoping that will be the case before we adjourn for the March break, but I am not terribly optimistic that is going to happen.

I also want to invite, of course, Chairman Bernanke to work with us on this committee to get the kind of legislation that I think could make a difference in the foreclosure crisis area, and I want to urge Secretary Paulson to join the effort, as well, and I intend to ask today's witnesses about their views and the best way to address the current crisis in the question and answer period.

With that, Senator Shelby is not here, but let me turn to Senator Corker. You were here and arrived earlier, so let me ask you if you have any opening comments you would like to make, and if not, Senator Bennett, and then we will turn to Senator Reed.

STATEMENT OF SENATOR BOB CORKER

Senator CORKER. Mr. Chairman, thank you. I think this is a great hearing, again, and as usual, I really don't have any opening comments. I like to hear the witnesses.

But I will tell you, I do hope that as it relates to the housing issue, that we can do something in regular order and really work something out that maybe tries to really focus on the problem. The things that we have seen come forth informally have been a hodgepodge of things that focus on irrelevant parts of the problem, and I just want you to know that certainly I would look forward to sitting down and focusing on targeted efforts that really are aimed at solving a problem versus those that just are a collage of things that bail out various industries that have nothing whatsoever to do with the actual credit problem itself.

But with that, I thank you and look forward to these great witnesses testifying.

Chairman DODD. I appreciate it. By the way, as I have said both privately and publicly about Senator Corker, we are delighted to have you as a new Member of this Committee, someone who has spent a good part of his life engaged in this business, and so brings some very practical and solid background in dealing with questions. Having, I think, the 10,000 low-income housing units that exist in Chattanooga, Tennessee today, for a variety of reasons not the least of which there was someone named Bob Corker who made a difference in leading that effort, so he cares about these issues and has a long history of being involved in them.

So we welcome your knowledge and your background and expertise, and obviously focusing on the problem is the critical question. Also trying to mitigate the effects of the problem is something we need to look at, as well, and I know the Senator cares about that as much as I do.

Senator CORKER. Thank you.

Chairman DODD. So I thank you very much.

Senator Reed, any opening comments?

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you, Mr. Chairman. Thank you for holding this hearing along with Senator Shelby, and I want to welcome all the witnesses. We rely extensively on your expertise, your experience, and your profound interest in these issues. I am particularly pleased to see Nancy Andrews here from the Low Income Investment Fund, and we will talk a little bit about affordable housing funds, I hope.

We have made progress in terms of establishing, I believe, the consensus that the Chairman reflected that we do need a strong independent regulator. The question of details is still being sorted out, but that is a position I think we all share.

But within the context of this legislation, I think we also have to commit ourselves to affordable housing. The House has taken, I think, a very substantial movement in this direction and I hope we can match it.

What we are seeing is historic foreclosures taking place. In fact, I think the Mortgage Bankers are releasing a report. Unfortunately, we are setting a record, and we are also setting a record in those people falling behind in their payments so foreclosure is 1 month or 2 months away for many.

One of the ironies here is it is putting additional pressure on the rental housing market. As people are thrown out of their homes, where do they go? And in my State of Rhode Island, I think it is not uncommon, Connecticut and elsewhere, we don't have a situation where we have got these huge track homes that were overbuilt, like in California, Florida, or Nevada, et cetera. We have a defined base of houses, residences. What has happened, we have a credit bubble. The price has been driven up and now it can't be afforded. And so you are throwing people out of homes into rental situations and there is not an expansion of the rental property market. It is the perfect storm.

So I think we can't, as we move forward with GSE reform, neglect our obligation to continue to provide affordable housing through renovation, construction, expansion of the rental market particularly, and some home ownership.

I hope we can make progress. There are several things we must do. I think at the very top of the list is GSE reform with an affordable housing component. I look forward to the testimony.

Thank you.

Chairman DODD. Thank you very much, Senator.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Mr. Chairman, you and I have been on this committee long enough to know that the GSE soap opera has gone on for far too long. We have had the hearings on the restating of earnings. We have had some conversation that comes close to being public flogging of some of the executives of the GSEs. And then ironically when the subprime crisis hits, the GSEs emerge as the heroes because they are the only ones that have any money left to make it possible for people to refinance or hang on to their homes. It is time we brought the soap opera to a close, created the strong regulator that we have been saying for years we need, and I salute you for your determination to do that.

With that, I look forward to the witnesses.

Chairman DODD. Well, thank you very, very much, and let me introduce our witnesses briefly and then I will ask you to try and limit your comments to somewhere around 5 to 7 minutes, if you could.

Let me just inform all of my colleagues as well as our witnesses that all of your testimony and any supporting documentation you think would help us understand your testimony better will be included as part of the record. So even though your remarks may be relatively brief and your prepared testimony may exceed that time, I want to make sure that it is going to be included in the record of the committee's hearing this morning.

Our first witness is Bill Shear. Bill, we thank you for being with us. He is Director of Financial Markets and Community Investment of the U.S. Government Accountability Office. Mr. Shear has directed substantial bodies of work addressing the Small Business Administration, the Federal Housing Administration, regulation of the housing GSEs, the Rural Housing Service, and Community and Economic Development Programs, and brings a wealth of experience and knowledge to the subject matter.

Vince Malta is the Chairman of the Public Policy Coordinating Committee of the National Association of REALTORS®. He is also a co-owner of Malta and Company, located in San Francisco. He has received numerous awards, including the Wall Street Journal Award for his leadership in business and REALTOR of the Year for San Francisco in 1996 and for the State of California in 2006.

Mr. Kieran Quinn is our third witness, a good friend, Chairman of the Column Financial, a Credit Suisse mortgage lending subsidiary for multi-family and commercial properties based in Atlanta, also the Managing Director of Credit Suisse. Mr. Quinn is Chairman of the Mortgage Bankers Association, and Kieran, we thank you for being with us this morning.

Jerry Howard is the Executive Vice President and Chief Executive Officer of the National Association of Home Builders. Prior to joining NAHB, Jerry served as the chief lobbyist for the National Council of State Housing Agencies, where he was instrumental in the development of low-income housing tax credits as part of the Tax Reform Act of 1986. He came to this area as tax counsel in 1988 and served in a variety of roles, including the chief lobbyist for the Home Builders. Jerry was promoted to Executive Vice President and Chief Executive Officer in 2001, so he has had a long history. Jerry, I am pleased to see you again. You have been very helpful in the past.

And finally, Nancy Andrews. Nancy, we thank you for being here, as well, this morning. She is President and Chief Executive Officer of the Low Income Investment Fund. It is low income investments in capital and technical assistance activities that have supported the development of 54,000 affordable homes for families and children, 47,000 spaces of child care, and 41,000 spaces in school facilities for low-income communities across the country. This Low Income Investment Fund targets the poorest of the poor, and you have been very successful and we commend you for your efforts and look forward to hearing from you this morning, as well.

With that, Bill, we will hear from you first, then work down the line, and after that we will begin our questioning.

STATEMENT OF WILLIAM B. SHEAR, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SHEAR. Mr. Chairman and Members of the Committee, I am pleased to be here this morning to discuss Federal oversight of the housing Government-Sponsored Enterprises. Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System continue to play a critical role in the nation's housing finance system. In this oral statement, I will focus on the second section of our written statement, addressing the current GSE regulatory structure. Simply put, I will emphasize why the establishment of a single Federal regulator with adequate authorities to oversee all housing GSE activities is critical to helping ensure that the housing GSEs' financial soundness is secure while they continue to provide housing opportunities for American families.

The current housing GSE regulatory structure is fragmented and not well equipped to oversee their financial soundness or their housing mission achievement. The Office of Federal Housing Enterprise Oversight, called OFHEO, is responsible for safety and soundness oversight of Fannie Mae and Freddie Mac, while the Federal Housing Finance Board is responsible for safety and soundness and mission oversight of the Federal Home Loan Bank System. Both regulators lack key statutory authorities to fulfill their safety and soundness responsibilities as compared to the authorities available to Federal bank regulators.

Moreover, HUD, which has housing mission oversight responsibilities for Fannie Mae and Freddie Mac, faces a number of challenges in carrying out its responsibilities. In particular, HUD may not have sufficient resources and technical expertise to review sophisticated financial products and issues.

Creating a single housing GSE regulator could better ensure consistency of regulation among the GSEs. A single regulator would be better positioned to consider potential tradeoffs between mission and safety and soundness.

While critics of combining safety and soundness with mission have voiced concerns that doing so could create regulatory conflict for the regulator, we believe that a healthy tension would be created that would lead to improved oversight. In addition, a single regulator could be more independent, objective, efficient, and effective than separate regulatory bodies and could be more prominent than either one alone. We also believe that valuable synergies could be achieved and expertise in evaluating GSE risk management could be shared more easily within one agency.

Finally, I want to emphasize that to be effective, the single regulator must have all the regulatory oversight and enforcement powers necessary to address unsafe and unsound practices, respond to financial emergencies, assess the extent to which the GSE's activities benefit home buyers and mortgage markets, and otherwise ensure that the GSEs comply with their very important public missions.

Mr. Chairman, it is a privilege to be here. I would be happy to respond to any questions.

Chairman DODD. Thank you very much, Mr. Shear.

Mr. Malta, for the record, thank you for being here.

STATEMENT OF VINCENT E. MALTA, CHAIR, NATIONAL ASSOCIATION OF REALTORS®, PUBLIC POLICY COORDINATING COMMITTEE

Mr. MALTA. Chairman Dodd, Senator Shelby, and Members of the Committee, thank you for inviting me to testify on the important issue of Government-Sponsored Enterprise reform. My name is Vince Malta and I am the broker owner of Malta and Company, a San Francisco-based real estate sales and management firm. I am also the 2008 Chair of the Public Policy Coordinating Committee of the National Association of REALTORS®, and I serve voluntarily on Fannie Mae's National Housing Advisory Council.

Today, I am here to share the views of more than 1.3 million REALTORS® who engage in all aspects of the real estate industry. Fannie Mae and Freddie Mac are our partners in the real estate industry. We want to keep them strong and sound.

REALTORS® support H.R. 1427, the Federal Housing Finance Reform Act of 2007, which overwhelmingly passed the House of Representatives on May 29, 2007, and we are eager for the Senate Banking Committee to pursue similar GSE reform legislation focused on several key elements which are detailed in my written testimony.

In the interest of time, my remarks will focus on two points. First, the GSEs need a strong regulator and strong corporate governance. Oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks should be transferred to a new regulator which has the authority to set capital standards, liquidate a financially unstable enterprise, and approve new programs and products. The regulator also should understand and support the GSEs' vital housing finance mission and the role housing plays in supporting the national economy.

Second, REALTORS® ask that Congress permanently raise the GSE loan limits. While we greatly appreciate the loan limit increase included in the economic stimulus package, it will not be in place long enough to alleviate the current credit crisis. NAR urges the Senate to permanently increase the national conforming loan limit to $625,500 or higher. In addition, for high-cost areas, the conforming loan limit should be permanently increased to 125 percent of the local median home sales price, but not exceed $729,750.

Increasing the national GSE loan limit to $625,500 with an additional increase of 125 percent of the local median home sales price in high-cost areas would boost the housing market and the economy in a number of ways. More affordable loans will help bolster home buyer confidence and bring people back into the marketplace. That can mean as many as 348,000 additional home sales, lower inventories, and a two to 3 percent increase in home prices. A boost in home prices could reduce the number of foreclosures by as many as 210,000 by making it easier for consumers to refinance or sell.

According to our estimates, the new limits would enable more than 500,000 borrowers with loans above $417,000 to refinance to lower interest rates. While jumbo mortgages may be associated with luxury housing in some parts of the country, they have become the primary option for large numbers of working-class people who live and work in more expensive areas of the country, like my home State in California.

There is precedent for regional adjustments for high-cost areas. In 1980, Congress designated Alaska, Hawaii, Guam, and the U.S. Virgin Islands as high-cost areas. The conforming loan limit in these statutory high-cost areas is 50 percent higher than the rest of the nation. However, housing prices in many areas of the country now exceed those in Honolulu, for instance. Additional increases in the loan limits in such areas will ensure that borrowers and homeowners across America have access to the same low-cost mortgages. Let us not forget that by raising the GSE loan limits, we could stimulate $44 billion in additional economic activity.

Again, REALTORS® urge the Senate to increase the national conforming loan limit to no less than $625,500 and to make the conforming loan limit increase for high-cost areas as provided in the economic stimulus legislation permanent.

In conclusion, Fannie Mae and Freddie Mac are vital to the housing sector for providing liquidity and stability in the mortgage market. Targeted reforms should strengthen and expand their presence in the housing finance system, especially now when we need them the most. The National Association of REALTORS® pledges to work with the Senate to enact GSE reform legislation that achieves our mutual goals and protects the vibrancy, liquidity, and stability of the housing finance system today and for many years to come.

Thank you again for the opportunity to testify and I will be happy to answer any questions.

Chairman DODD. Thank you very much, Mr. Malta. We appreciate it very much.

Kieran, we thank you for being here. I don't know if you have the MBA data that is coming out this morning, if you have that with you already——

Mr. QUINN. I have some highlights. We don't release it until 10, even to me.

[Laughter.]

Chairman DODD. It is already on the website here, but welcome. We are happy to hear your delinquency rates are—the numbers I am getting are 5.82 percent for all loans. That is an all-time high since MBA has collected data, I am told, on delinquency rates. Loans in foreclosure, 2.04 percent. That is another record high. Fourteen-point-forty-four percent of subprime loans are either seriously delinquent or in foreclosure, an increase of over 3 percent for the third quarter and nearly double for last year. Those are some notes I have received. Welcome.

STATEMENT OF KIERAN P. QUINN, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

Mr. QUINN. Thank you. Mr. Chairman and Members of the Committee, thank you for the opportunity to testify for the Mortgage Bankers Association today.

First, I would like to thank Congress and the administration for the swift action on the stimulus package last month. The temporary increase in loan limits for FHA, Fannie Mae, and Freddie Mac will help consumers by increasing mortgage financing options and will particularly help restart the securitization market for higher-cost housing markets like California and parts of New England and New York.

Fannie Mae and Freddie Mac, the GSEs, are critically important in mortgage financing. MBA strongly supports the role the GSEs play in maintaining and improving liquidity and stability in the secondary mortgage market. For these reasons, MBA has long advocated regulatory reform to ensure that GSEs are operating in a safe and sound manner, engaging in activities consistent with their charter purposes, and are subject to reasonable affordable housing goals that do not distort the market.

My written statement is comprehensive, so I will touch on a few highlights here.

There seems to be general agreement on the fundamental tools the new regulator will need. MBA is particularly interested in the powers of the regulator related to the review and approval of GSE activities, ongoing and new. The new regulator should be given the explicit authority and direction to ensure the GSEs' activities are permitted by their charters and other applicable law. Though MBA would suggest a few improvements, we believe the product approval and activity review language in the House-passed bill is an improvement over current law and heads in the right direction to satisfy industry concerns that the GSEs remain true to their missions and authorities.

We support the creation of an Affordable Housing Fund and appreciate the provision in the House-passed bill that would calculate the amount of the GSEs' contribution to the Affordable Housing Fund on the size of its portfolio rather than its net income. This approach would make it more difficult for the GSEs to pass the costs of their contribution on to mortgage lenders and to consumers. It would also establish a monetary connection between one of the benefits derived by their government sponsorship, lower capital costs, to their charter-based affordable housing obligations. If the funds are distributed by formula to State and local agencies to administer, MBA recommends a process similar to the HOME program be used so that both cities and States receive an allocation and have the ability to target those funds to areas of greatest need.

MBA maintains the GSE portfolios are important tools that augment their ability to help stabilize mortgage markets and encourage affordable housing. Because these markets are so dynamic, the GSEs need flexibility to adjust their portfolios in response to changing conditions and marketplace needs.

Similarly, the GSEs' regulator also must have sufficient flexibility to adjust to changes in the GSEs' risk profile or other market circumstances as it regulates GSEs' portfolios. The House-passed bill's treatment of portfolio regulation is consistent with MBA policy.

Another important tool is the ability of the regulator to set and adjust minimum and risk-based capital levels for GSEs. MBA supports a flexible bank-like regulator approach to capital regulation.

Finally, Congress should strengthen both the secondary mortgage market and the Federal Home Loan Banks by expressly affirming the banks are authorized to securitize mortgage loans.

Thank you, Mr. Chairman, and we look forward to continuing to work with you and this committee on this important matter.

Chairman DODD. Thank you, Kieran, very much.

Mr. Howard.

STATEMENT OF GERALD M. HOWARD, EXECUTIVE VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. HOWARD. Chairman Dodd, Members of the Committee, thank you for the opportunity to testify here today. I think you are hearing overall consensus that we need swift action on GSE regulatory reform.

The GSEs are critical components of the nation's housing finance system. Their mission is to play a vital role in maintaining mortgage market liquidity and stability and promoting affordable housing. It is important, therefore, that the GSEs remain financially safe and sound and focused on their Congressionally chartered purposes.

The GSEs offer tremendous potential to relieve the liquidity problems in the nation's mortgage markets and bring immediate benefit to the overall economy. With the U.S. housing market experiencing the most severe downturn since the Great Depression, the benefits of the housing GSEs are needed more than ever. Unfortunately, the GSEs are not currently fulfilling their potential due both to corporate reticence and deficiencies in the current regulatory framework.

NAHB believes that Fannie Mae and Freddie Mac have not accomplished as much as they should, particularly in the area of the subprime mortgages. Rather than aggressively pursuing market solutions, they are hunkering down in a defensive position far from the front lines of mission achievement. In addition, both companies are imposing a multitude of additional fees that will raise mortgage borrowing costs for the very individuals and families who are the most in need of the GSEs' benefits. Fannie's and Freddie's response to the mortgage credit crisis should be activities to stabilize markets and fill funding gaps, not take steps to tax already struggling mortgage borrowers.

Fannie Mae and Freddie Mac are confined by their charters to the conforming loan limit and thus have not been able to provide assistance to the jumbo market. NAHB appreciates the recently signed economic stimulus package that provides for a temporary increase in the conforming loan limit in high-cost markets. Expanding the dimensions of the conforming market is an important step toward restoring the stability and liquidity in the broader mortgage markets.

However, the bifurcated system for regulating Fannie Mae and Freddie Mac will remain a major impediment to effective mission pursuit by the GSEs. This convoluted system is simply not working. Until last week, OFHEO maintained restrictive limits on the portfolio purchases of Fannie and Freddie and OFHEO continues to impose a 30 percent capital surcharge on both companies. These restrictions have hamstrung the enterprise.

Further, there is poor or nonexisting coordination between OFHEO and HUD. There is also indifferent mission oversight from HUD, which should be requiring more, not less, in the present dire market circumstances. Clearly, regulatory reform is long overdue and urgently needed.

To that end, NAHB appreciates this committee's commitment to enacting legislation to improve and bolster the regulatory framework for the housing GSEs. Although there are a myriad array of factors and ingredients to consider in the current reform debate, given the time here, I will leave NAHB's detailed views to my written statement.

Nevertheless, NAHB believes this process can be a success without undercutting the GSEs' housing mission if the following areas are addressed. One, balancing housing with safety and soundness concerns. Two, maintain the GSEs' flexibility to respond promptly within their charters to market needs. Three, extend the increase of conforming loan limits in high-cost areas. Four, focus and enhance the GSE benefits to expand affordable housing opportunities. Five, employ capital as the precise instrument of risk management. And six, preserve the GSE portfolios as tools for achieving liquidity and affordable housing mission.

Single-family housing starts are already down by 60 percent from their peak in the beginning of 2006 and the bottom is not yet in sight. Moreover, this dramatic contraction has exacted a heavy toll on economic growth and employment during the past 2 years and is now pushing the U.S. toward the brink of recession. With decisive and appropriate action on behalf of this committee, Congress, and the administration, passage of a comprehensive GSE reform bill has the ability to greatly relieve liquidity and inventory pressures in the mortgage credit markets, help stabilize housing prices, and bolster consumer confidence and thus bring benefit to the overall economy.

Mr. Chairman, NAHB congratulates you for your leadership in this regard and we look forward to working with you and I am prepared to answer any questions.

Chairman DODD. Excellent testimony. I appreciate it very much, as well.

Ms. Andrews.

STATEMENT OF NANCY ANDREWS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, LOW INCOME INVESTMENT FUND

Ms. ANDREWS. Thank you, Chairman Dodd and Members of the Committee. My name is Nancy Andrews. I am the President and the CEO of the Low Income Investment Fund. We are a national Community Development Financial Institution, a CDFI, and our mission is poverty alleviation.

I have three points that I want to make. First, having safe, sound, and strong GSEs focused squarely on the mission of affordable housing is essential.

Second, deeply targeted affordable housing must be a part of any GSE reform effort, and the creation of the Affordable Housing Fund will accomplish this.

And finally, the formation of the Capital Magnet Program as envisioned by Senator Reed will have the greatest impact for leveraging capital to serve deep-reach projects in very low-income communities.

The need for affordable housing is tremendous. We see it every day in the communities that we work in and it is growing. The National Low Income Housing Coalition estimates that there is a deficit of over five million units affordable to very low-income families. We respond to this problem by providing capital when banks cannot or will not lend. Three-fourths of everything we do serves families that are below 50 percent of median income. That is very low-income families. And yet over two decades of work, we have suffered capital losses of less than one-tenth of 1 percent.

The track record of my organization is not unique. It is mirrored by Community Development Financial Institutions all over the country, and in my written testimony, I have included examples in each of the States for the members on this committee so that you can see what is being done in your area.

My very first point is a belief that a strong and sound GSE system is essential to healthy housing markets, but we also support strengthening the goals, the affordable housing goals, particularly multi-family and refinance goals proposed by Senator Reed. GSEs must lead the market and they must also lead us in tackling the subprime problem.

There is a part of the housing production spectrum, however, that they have not yet been able to reach well, and that is producing affordable rental housing and ownership housing for very low and extremely low-income families, and this leads to my second point. We support Senator Reed's proposal to create an Affordable Housing Fund, requiring the two agencies to set aside 4.2 basis points of each dollar of new business. This does not include the Federal Home Loan Banks because they already have their own program. But 65 percent of this set-aside would go into an Affordable Housing Block Grant Program that would be distributed to the States by formula, and in its first year would be dedicated to the subprime crisis. After that, it would support the production of deeply affordable housing for very low-income and extremely low-income families.

My third point is to endorse the Capital Magnet Fund as proposed by Senator Reed with the set-aside of the remaining 35 percent of the Affordable Housing Fund. The purpose of this fund would be to leverage private dollars with GSE dollars and expand housing opportunities and economic opportunities in very low-income communities.

CDFIs across the country leverage $19 for every one dollar of Federal support that they receive. We would use the Capital Magnet Fund to use the resources that GSEs earn, partly on the strength of their special relationship with the government, and we would put them to work more effectively than Freddie or Fannie can do independently serving these deep-reach populations.

So in conclusion, we believe that the GSEs can and must play a stronger role supporting housing that is deeply targeted. They must also be financially sound, and this comes first. But working with the GSEs, we believe that we can draw private investment into projects that they would not otherwise be able to support. We can do this safely, we can do it soundly, and we can multiply the impact of their investment many times over. It is the combination of strengthened goals with the Affordable Housing Block Grant Program and the Capital Magnet Fund that we believe will create a formula of success, allowing the GSEs to reach more deeply than ever before.

Thank you, and I will be happy to take questions.

Chairman DODD. Thank you very, very much for your testimony. I thank all of you for your testimony and the brevity. You did a good job at getting through that as well.

I will set the clock here for about 7 minutes per member. There are few of us here, so we should be able to move around fairly quickly on all of this.

Let me, if I can, just let me begin with something I raised early on, and that was the issue of this whole question of what has gone on recently with the GSEs regarding providing their worth in the current crisis. The discriminatory pricing system is of some concern to me, usually with regards to certain cities and ZIP codes. Doesn't it at least partially undermine the benefit of the GSEs—some of you raised this issue and it is of concern to me and I want all of you to comment, if you could, on it, if you are interested—by raising prices and/or credit standards in neighborhoods where credit may already have disappeared?

These are Government-Sponsored Enterprises. The very notion here was for them to be in areas where traditional market opportunities are not going to be there, and to the extent they are tightening up in the very areas we are looking for help in here sort of undermines the very purpose, or at least one of the purposes of their existence. I wonder if anyone wants to comment on that, as well. My concern is Fannie and Freddie are designed to help alleviate some of these problems and in a sense we are making it worse in certain areas rather than contributing to the benefit.

Mr. Malta.

Mr. MALTA. Senator, we agree wholeheartedly. Our members are greatly concerned about the effect this will have on the market when we need Fannie and Freddie the most. NAR believes these policies will make home buying less affordable, and we have questioned the disparate impact of the policies on minorities in low-income areas, especially when the average down payment for first-time home buyers are 2 percent in those instances. NAR raised our concerns with the GSEs. We will be talking with them some more. Doing it by ZIP code is wholly inadequate. Properties should be based on their own merit by property and not by ZIP code.

Chairman DODD. Are we getting near a redlining sort of approach here that has occurred in the past?

Mr. MALTA. We have heard those arguments, but again, we believe a property-by-property analysis, not done on ZIP code. In my area, one block makes a huge difference as to whether a market is declining or not for a variety of reasons—views, schools, et cetera.

Mr. HOWARD. The Home Builders agree with that, Mr. Chairman. I have to tell you that we are appalled at the increases that Fannie and Freddie are putting on home buyers at just the absolute worst time. We think it is total disregard for their mission statement.

But on the other hand, it also, I think, evidences the failure in the current regulatory system. Their safety and soundness regulator has been so strident, so aggressive in his regulatory efforts while the counter-regulator for housing mission has not been as aggressive. It shows the failure in the system and the need for the instant legislation.

Chairman DODD. Does anyone else want to comment on this issue?

Mr. SHEAR. I would like to add to that. It is a classic conflict, even without commenting directly on the risk-based pricing that is involved, it is a classic conflict between mission achievement and safety and soundness. This is one of the reasons why we think that the current inability to look at these sophisticated corporations in a whole way, and why a single regulator that does deal with that conflict is so important.

Chairman DODD. Let me bring up—Mr. Howard raised an issue here that is one of the contentious points in this legislation as we look at it. Everyone is for a strong regulator. There are certain matters we all agree on here. There is no debate about it. It is when you get into the details here that you find some divisions occurring, and one of the areas of some division is to what extent with innovative products you have to get a comment period, this concern that if we are going to require that, you are going to limit the ability of the GSEs to respond promptly to new ideas and that many of these ideas aren't terribly new in many ways.

Mr. Howard, in your testimony, you seemed to indicate, at least part of your testimony as I listened to you and read the testimony here, you are concerned that this may limit the ability of GSEs to be creative and innovative. And yet others seem to be arguing somehow that this is exactly the kind of thing we want to limit, in effect, from the GSEs. Do I understand your testimony correctly——

Mr. HOWARD. Yes, sir.

Chairman DODD [continuing]. Your concern about that? And how do you feel about that, Mr. Shear? This is new program approval, is what I am talking about.

Mr. SHEAR. I know, and we think new program approval is a very important function because the GSEs are meant to serve a public mission and they have certain charter responsibilities. Having said that, what we are looking for is a regulatory framework that really treats what is a new program by making the distinctions as to whether it is contributing to the mission or causing the GSE to go outside of its mission boundaries.

So there has to be a reasonableness in terms of how we define a new program or activity. I don't think anyone is saying that changing underwriting standards a little bit results in a new program or a new activity, but there has to be a balance that is created to allow some innovation without allowing the GSEs to go outside their charter boundaries.

Chairman DODD. On page nine of your testimony here, you listed the areas where you thought these powers ought to be, the cease and desist authority, removal and prohibition authority related to officers and directors, prompt corrective action authority for inadequate capital and other unsafe and unsound conditions, authority to resolve critically undercapitalized GSEs. You sort of left out this area that I just talked about.

I don't disagree at all with what you are just saying, but the question is whether or not we are going to give extraordinary power to the new regulator here that would somehow make it more difficult for the new approval process to go forward. Am I am reading you correctly? If you have got a strong regulator, you are less worried about specifically requiring that kind of comment period and so forth that is being suggested by some?

Mr. SHEAR. The comment period, we haven't evaluated the comment period, but I will just make the observation that in many cases, you don't want a period that goes on too long. So we really don't have a position on the comment period, but we are very mindful of the idea that when introducing innovation in a marketplace sometimes there is a need for response. There is some accommodation of that in the current authority that HUD has, but as you know, we have concerns about HUD as a mission regulator. As to safety and soundness, there has to be an accommodation there, too, a reasonable accommodation. Many of those authorities you mention pertain to safety and soundness issues.

But part of this, in having a single regulator, what we are envisioning is a regulator that would be subject to using the rulemaking process so there would be an expert regulator with discretion in using those powers. But beyond Congressional oversight, you would have a system through the promulgation of rulemaking processes that would bring some transparency and accountability to how oversight that was addressed.

Mr. QUINN. Senator, in our testimony, we try to separate the secondary market and the primary market——

Chairman DODD. Right.

Mr. QUINN [continuing]. And anything that the GSEs would do to create more liquidity in the secondary market, we are all for. We just—we believe we have a very competitive primary market today and we like to keep the focus on their activities in the secondary market.

Chairman DODD. Mr. Howard.

Mr. HOWARD. Mr. Chairman, I just want to point out that the impact of the current economic stimulus package is going to be greatly diminished by the regulatory process that the GSEs have to go through. If OFHEO takes some of the time that they have taken on past new product approval to approve the increase in the conforming loan limits, the statutory deadline of December 31 of this year will come and go before it can even happen. So it underscores, again, the importance of getting this done and setting the regulator up to be able to approve new programs in a timely way so that they can respond to market conditions.

Chairman DODD. Let me jump—there are a lot of questions here. Let me jump to the conforming—the loan limit issue, and Mr. Malta, you raised the issue that 417 is just too low. Now, you are from California and San Francisco and no one is going to argue with you about 417 in San Francisco. But I suspect if Senator Shelby were here, he would say, "Well, I live in Alabama," and a very different real estate situation than exists in your State and particularly the city in which you reside. I live in Connecticut. I can make a case on either side of this issue, as you can obviously in California.

Let me be the devil's advocate. Why would we be talking about raising this thing? Some have suggested $700,000, $600,000. I mean, basically we are talking about an upper income category here, getting beyond the mission statement of the GSEs to set loan limits at that high of a level when they ought to be focusing their attention on those who really need the resources going to areas where people are struggling to get into the greatest wealth creator they are ever going to have for them, is being able to purchase that home, develop and to build that equity in it to provide for their long-term financial security and the like. You are going to move this whole program into an area here that goes far beyond what was ever intended by the GSEs. What is your answer to that?

Mr. MALTA. Well, Senator, we did some analysis based on what HUD has posted as those counties that are over 417 and there are 249 counties in the country that are over 417, which spread over to 19 States and, of course, your State of Connecticut. Utah is included. Tennessee is included as well as other States that are familiar high-cost areas. Income in those high-cost areas just have not kept up to pace with the home prices.

In San Francisco, for instance, as you have pointed out, $805,000 buys the median house in San Francisco. With 20 percent down at today's current jumbo rate loans, a person has to make over $214,000 to qualify to buy that median-priced home. Census statistics show that the median household income in San Francisco is $65,000 and jumbo loans are getting more expensive. They have gotten more expensive during this crisis. So income has not kept pace with home prices in a lot of these areas.

Chairman DODD. Do you want to comment on this, Nancy?

Ms. ANDREWS. I do. I think in many ways what this does is really underscore the points I made in my testimony, which is the need for a different way of approaching deeply targeted households. Incomes simply have not kept up with the cost of housing. When the housing costs are taken into account, people are literally thrown into poverty because of it and we need to find ways to respond to that, and that is why we believe special attention to the Affordable Housing Fund is very, very important, particularly in this climate right now.

Chairman DODD. Let me——

Mr. QUINN. Senator, in your opening comment, you talked about Fannie, Freddie, and the Federal Home Loan Banks. They are the market today.

Chairman DODD. I know that.

Mr. QUINN. We supported the 50 percent increase up to the 629 to cover all States, because we met with members in Utah last Friday who wished that they had that availability because there are sections in Salt Lake that could have used the higher loan limit, across the board, all 50 States.

Chairman DODD. Well, I am being a bit of a devil's advocate in raising the question here. As you point out, in my own State, we are one of those 19 States—certain parts of my State obviously are. But there is a case to be made and obviously the point of having a strong affordable housing feature to this bill would mitigate a lot of these problems we are talking about as you do both. So it needs some adjustment. I am not suggesting as high as you are possibly in favor of, Mr. Malta, but I certainly think an increase is warranted here to reflect the realities of what is going on in the marketplace.

Do you want to comment on that? I am sorry.

Mr. MALTA. Senator, by creating a market for these jumbo loans, it could free up money——

Chairman DODD. I understand that——

Mr. MALTA [continuing]. That could go toward——

Chairman DODD. I made that argument, not with any great success, by the way, over the last year or so.

[Laughter.]

I have got to address, Kieran, the question of these numbers coming out from the mortgage bankers. I would be remiss, quickly here, if we didn't ask you to comment on what you see in all of this. I just will mention here again, this is a handwritten note, so I am presuming these numbers are correct, as I look back at my staff here. The data this morning from the Mortgage Bankers Association has delinquency rates are getting close to 6 percent for all loans, and again, to put it in perspective, that is apparently an all-time high. I don't know how long MBA has been collecting data, but for however long you have been collecting it, that is a high.

Mr. QUINN. A long time.

Chairman DODD. Loans in foreclosure, again, in excess of 2 percent. That is another record high. Fourteen-and-a-half percent, roughly, of subprime loans are either seriously delinquent or in foreclosure. That is an increase of over 3 percent for the third quarter and nearly double from last year.

I am going to tell you, I have wonderful conversations with my good friend from Tennessee who likes to try to remind me to keep this in perspective here, these numbers. And so while these numbers are record-setting numbers, in the context of everything else that is going on out there, there needs to be a perspective about it, and I am sure he will articulate this point when he gets to you, but tell me, what is your read on all of this? This is the last question I will have for you here, any thoughts you have, the panel here, that you think the administration, the Treasury, the Fed, we up here—obviously, we know about GSEs, we know about FHA, we are working hard to get that done. Anything else you would be recommending here for us to take into consideration?

[Ringing telephone.]

Chairman DODD. That is my phone going off there.

[Laughter.]

Any thoughts you would have for us up here as we are looking at a variety of ideas to be constructive, to be responsible in terms of doing what is necessary for us?

[Ringing telephone.]

Chairman DODD. This is a persistent caller here.

Mr. QUINN. Senator, I will remind everyone that the study is effective——

Chairman DODD. I am not Rudy Giuliani, by the way.

[Laughter.]

We were in the same office, but I never tried that trick, I can tell you.

[Laughter.]

Mr. QUINN. The study is effective 12/31/07. Your numbers are entirely correct. The Hope Now Alliance was really kicked into gear on or around December 1. We saw a dramatic increase since the 500,000 letters went out in the month of December. The frustration we have had all along, and it has been verified by every major regulator, 50 percent of the cases where a home goes to foreclosure, we can't get in touch with the person living in that home. They have either left ahead of time or just don't feel that there is a hope. So your hearing today does a great job of expanding the knowledge and the awareness of the Hope Now Alliance, the 1–888 number, HOPE NOW number.

The one number that came out of this study, they told me on the way out, is in the Midwest where this all started, we are starting to see some stabilization. That is just a start. We do believe foreclosures will continue to increase this year.

There are several things, though. You have done the stimulus package. You have raised the limits. We would like to see the FHA modernization. That is where——

Chairman DODD. We are going to get that done. I mean, we are very, very close. I reported yesterday, said last evening, Senator Shelby, his staff, our staff, Barney Frank and his and other members were—literally, my hope is that literally in the next few days, we will have an agreement on that bill and can move forward. We are down to basically one issue, and I won't bother getting into that in a public setting, but we are very close to getting that done.

Mr. QUINN. That is equally a key part of our legislation.

As far as some of the ideas, we don't have any current policy on sort of the—I call it the Resolution Trust Corporation. Chairman Bernanke mentioned it yesterday to some of the community bankers.

Chairman DODD. Right.

Mr. QUINN. But we are willing to come in and talk about that at any time.

Chairman DODD. Does anyone else want to comment here on that open-ended question, just some ideas about—yes, Mr. Malta.

Mr. MALTA. Senator, the REALTORS® support the Affordable Housing Fund that has been talked about.

Chairman DODD. Right.

Mr. MALTA. On the House of Representatives side, it was in H.R. 1427. We supported that. We supported the stand-alone bill that Chairman Frank had. We would suggest respectfully that you examine that as a stand-alone bill, as well, because of the contentious manner of that issue, as important as it is, though, so that we don't slow the work that you are doing in GSE reform.

Mr. HOWARD. Beyond the jurisdiction of this committee, and I guess evidence of the complexity of the housing finance system itself, within the tax code, there is the expansion of the Mortgage Revenue Bond Program that could be a very big help.

Chairman DODD. Yes.

Mr. HOWARD. There is the notion of a tax credit, either temporary in nature to help stimulate home buying——

Chairman DODD. You would do that—Johnny Isakson has been talking about that idea, and as I understood his original proposal, it was to provide that credit to people who would move into foreclosed properties.

Mr. HOWARD. That is correct.

Chairman DODD. Is that correct? It wasn't open-ended to just anyone.

Mr. HOWARD. That is the Isakson proposal. In 1975 and 1976, President Ford and the Congress worked together on a proposal to stimulate purchases of new homes and reduce the overhang in inventory and thus stimulate the economy. That is another concept that we think has merit.

Chairman DODD. I am very intrigued by that idea, and, in fact, welcoming of that idea. Obviously, as you point out, it is a Finance Committee issue, but you will understand my concern. I would like to avoid that as much as possible and make it possible for people in their homes to stay in their homes.

Mr. HOWARD. Sure.

Chairman DODD. But if that fails, then obviously having some means by which you put that property back into private hands where they are generating tax revenues and creating wealth for the family that has moved in. But to the extent I am able to avoid that from happening is something we are looking at, as well, and that is where some of these other ideas are emerging.

Ms. ANDREWS. If I may, Mr. Chairman, I would like to urge you to continue to include the Affordable Housing Fund in this legislation because of the obligation that we believe that the GSEs do have. They can do something very unique. They can touch a part of the population that is not being served by any other program that we have. And missing this opportunity within this legislation, I think, would be a terrible waste.

Chairman DODD. I hear you, Ms. Andrews, and my intention here is to do everything possible to keep that as a part of this package, as well.

I have taken a lot more time than I said I would and I apologize. Bob.

Senator CORKER. Actually, since I know we have gotten off the initial focus here, which I think is a good thing, by the way, and I want to do the same, but since Senator Bennett has had such a history with the primary focus of this, I am going to go ahead and let him go first and then follow up.

Chairman DODD. That is a new Senator, very smart on the seniority system.

[Laughter.]

I was never that—when I sat in that chair down there, Jefferson was President when I was actually sitting there, it was that long ago.

[Laughter.]

Senator BENNETT. You are assuming I am totally prepared.

Mr. Howard, you have talked about the expiration date that is in the current legislation with respect to the change in the mortgage level. What is wrong with making it permanent?

Mr. HOWARD. Well, we had been very supportive of making it permanent, Senator, but just to show the severity of the dire consequences to our industry right now, we would settle for any extension of it. We have been working with some of the largest banks and the Financial Services Roundtable and have come up with a proposal to extend it for another 2 years. Any extension would be welcome, and permanency, of course, is something that we would very much like.

Mr. QUINN. Senator, our members would support the increase with GSE reform. That was the one caveat they gave us. Mandate to go temporary increases, but if you get GSE reform, we would be willing to go for a permanent increase.

Senator BENNETT. I don't think the housing market, as we work our way through this particular problem, is ever going to go back to a period where the lower rate makes a lot of sense. Yes, housing prices have spiked at, what, 50 percent, whatever, depending on what you take as your base to get the spiked amount, but in terms of the long-term trend going up, even coming down from the high, it is within the band of the long-term upward movement and therefore a permanent increase in that rate makes sense in the long term to me.

Now, Ms. Andrews, you testified to the shortage of low-income housing, and that is one of the factors here that we have talked about, we talked about in the previous hearing. If we take the overall numbers of the inventory overhang, it looks like our big problem is we have too much housing and we have to wait until the inventory is sold off. But if you segment the market, there is no overhang in the area where you are particularly concerned, and that gives rise to the possibility of somehow splitting the incentives and saying that the people who worked to create our problem—they didn't do it to create the problem, but the people who created the problem by buying houses in the hot markets in the hope that they could flip them and thereby created demand in the hot markets to the point where there is the overhang in Miami and California and other places, let them take the consequences of their actions.

I like the comment that is in the Washington Post where they say in their editorial, these decisions were made by grown-ups who were hoping to profit enormously, and when it turns out the market went the other way, they should pay the price for having bet incorrectly.

The people you represent are not in that circumstance, and as the whole building system, the home builders, Mr. Malta, are seized up by lack of credit, what could we do to increase lack of credit making money available for home builders to deal with the undersupply of housing in the area that Ms. Andrews represents so that they can go back to building homes while at the same time those who speculated for the vacation homes or the second or third home, the hot part of the market, pay the economic price of having made the wrong decision, but we don't impose that market discipline on the part of the market that needs home builders?

Here is a perfect supply and demand situation that is being interrupted by the availability of credit. Ms. Andrews' constituents need homes. Your constituents want to build homes. Why aren't we doing it? Because the money isn't available. The credit isn't available to have people buy it. Solve that problem for us, any of you.

Ms. ANDREWS. I would be happy to take a crack at it. I think the perfect solution really is in the proposed Affordable Housing Fund. This would provide a combination of subsidies that would allow the prices to be affordable to people at the bottom end of the income spectrum and therefore would help the production folks, and it would provide leveraged support that would allow lenders to get involved in that equation.

So, for example, our organization would be able to do the very early stage front-end stuff that is hard for the banks to do, get the projects ready for the private sector, and then have private money, construction funds and permanent funds, come in and take these out. So this is a perfect ramp, if you will, between that market segment and the private sector, both the building community and the lending community.

Mr. HOWARD. Senator, from the home builders' perspective, we are seeing now a lack of credit not only on the mortgage end, but on the acquisition, development, and construction end, as well.

Senator BENNETT. Right.

Mr. HOWARD. So from our perspective, the first thing that has to be done is to stabilize the financial markets as a whole through the tax credits, through FHA modernization. Even GSE reform sends the right message to the capital markets and to the consumers and will shore up confidence. That has got to happen before we could avail ourselves of anything in the Affordable Housing Fund, because right now, the builders are not getting credit themselves to even begin the development process.

Senator BENNETT. Let us take Johnny Isakson's idea and apply it to this particular problem. Johnny Isakson's idea is to deal with those properties that are going into foreclosure. Is there a tweak that could be made in tax incentives that would go in this direction, or Mr. Howard, are you saying that that is not the problem and that wouldn't be helpful?

Mr. HOWARD. This problem is so severe that that is a step in the right direction and would be helpful, but it is not going to be the panacea, I am afraid, that many believe it could be. So we would have to tweak it and I would have to have some time to get with some of our analysts and experts and even bring in people from the capital markets themselves and give you a more thorough answer, Senator.

Senator BENNETT. OK. Mr. Malta, you——

Mr. MALTA. Senator, yes. Johnny Isakson's proposal, REALTORS applaud the proposal and we see it both for new construction, for first-time buyers, for the credit applying for buying foreclosed property, et cetera. We see that liquidity in the market is absolutely essential to jump-start the market and buyers need an incentive to go out and buy property. They feel that next year, they could buy it at a lower price, so why get out there and do it? So these incentives in the marketplace, I think would be key to jump-start that.

Senator BENNETT. Anyone else? I see a perfect way to get home builders going, get REALTORS getting commissions, and solving the problem that seems to be, as you say, Mr. Howard, blocked by the fact that people can't get a hold of money. That is very interesting.

Thank you, Mr. Chairman.

Chairman DODD. Thank you. What I will do here is Senator Carper is on his way back. We have a vote going on. So we will take a 2-minute recess, but as soon as Senator Carper comes back, he will start the questioning, so we will just pause for a minute here until he comes back. I would normally stay, but the second bells have rung here, so we probably want to get over and vote.

We will be in recess for a couple of minutes.

[Recess.]

Senator CARPER [presiding]. Senator Dodd has gone to vote. He was good enough to allow me to reconvene us and we can continue to save some time. Thank you all for being here.

I apologize for arriving a little late. My oldest son is a senior in high school and we were making a college campus visit this morning and so I had my "Dad" hat on. That is the most important thing in my life, but the GSE regulatory reform is—maybe not a close second, but second or third, so it is important to me, and I think it is important to our country. We appreciate very much your input and your testimony today.

We had some other folks—actually, we had a lot of banking regulators before us earlier this week and I sort of reviewed with them a list of the issues that I think over the last several years we have come to agreement on with respect to regulatory reform for GSEs. No. 1 is the idea of combining OFHEO, combining the Federal Finance Board into one entity.

Second would be the independence of the regulator, the idea of having a regulator that is independent of the appropriations process, much as the other regulators are.

Third is the notion that instead of having to go through the Justice Department for litigation, this regulator would be independent and have independent litigation authority as other regulators do on receivership. This independent regulator for GSEs would have the power to put a GSE in receivership if it was ever needed. Hopefully, that won't happen.

The idea of combining mission oversight and new product authority into one world class regulator, we all seem to agree on. Flexibility for the regulator to set capital standards, whether they might be risk-based or minimum capital, there is sort of general consensus on that. And there is some agreement on restriction of the size of GSE portfolios.

But there are a couple of areas, maybe four or so, that we don't necessarily see eye-to-eye on. The House has been able to find common ground, but we have not, and I wanted to try to focus on some of those and to follow up on Senator Dodd's questioning.

We have been joined by Senator Jack Reed of Rhode Island, who has worked long and hard, and Jack, before you were here, Ms. Andrews and others were talking about your good work and hoping and encouraging us to ensure at the end of the day we pass a regulatory reform measure for the GSEs and that we include in it an Affordable Housing Fund.

There are at least three ideas out there for how to fund it, and Senator Reed has one of those. I want to ask—and I think there is a different approach in the House bill and I think there is yet a different approach for creating affordable housing through Federal Home Loan Banks, and I think their approach under law is 10 percent of net income. I think that is a requirement. I think there is a fund that is actually set up for that purpose and is a repository for those dollars.

What I would like for us to do is to focus on the three ideas, the existing practice that is within—the practice of the Federal Home Loan Banks under law; second, the proposal of Senator Reed which Ms. Andrews has alluded to; and the third is the approach in the

House bill with respect to how to fund an Affordable Housing Fund.

Let me just ask any of you to comment for or against, favorably or unfavorably, about any of those three options, please. Ms. Andrews, would you just kick it off?

Ms. ANDREWS. Sure. Well, first——

Senator CARPER. Let me just say, one of the things that I have heard about the idea of having what I call a transaction fee that would simply go into an Affordable Housing Fund as opposed to some percentage of net income is that you may have years like this year, like last year, where the GSEs, Fannie Mae and Freddie Mac lost a lot of money and yet they would still be required to put money into the Affordable Housing Fund. Safety and soundness concerns have been raised about that. A lot of years, they made a bundle of money, so it wasn't much of a concern, but last year it may have been a concern.

So that is sort of setting the stage for a little discussion here and let us just have it. Ms. Andrews, why don't you kick it off.

Ms. ANDREWS. Yes. The first thing I should say is we would be happy to consider all of those ideas and to think through all of those ideas. The key thing is to get this going and to find a way that everyone can agree that it should be funded.

We endorse the approach that Senator Reed has proposed, which is a small amount on the ongoing annual business, and we do that and he has proposed it in the context of making sure that there is safety and soundness and that the regulator has the judgment and the opportunity and the power if there is a financial—a year that poses financial difficulty, to cease the contributions going into that fund. So we feel that aligning it with the expansion of business, with the expansion of the GSEs' ability to do work, profitable work in our neighborhoods and in our communities is really the way to go about it with a strong regulator that can exercise judgment.

Senator CARPER. OK. Thanks so much.

Let me hear from others, please.

Mr. QUINN. Senator, we suggested a tax on the portfolio. They use their borrowings to support the portfolios. That is where they get the greatest advantage in the capital markets, so we thought that would be much more direct. We are very concerned with a net income or a fee on a transaction that gets passed directly over to the consumer.

Senator CARPER. Help me. The approach in the House bill—is that the approach they use in the House bill?

Mr. QUINN. I thought it was in Senator Reed's bill——

Ms. ANDREWS. The House bill, if I may, the House bill imposes a 1.2 basis point tax, if you will, on the stable book of business.

Mr. QUINN. On the portfolios.

Ms. ANDREWS. Senator Reed has proposed on the business flow.

Mr. QUINN. On the portfolios.

Senator CARPER. So you are suggesting——

Mr. QUINN. The House——

Senator CARPER [continuing]. The House approach. OK. Let me hear from some others, please.

Mr. HOWARD. I guess from our perspective, first and foremost, I agree with Kieran that we certainly don't want to see the GSEs pass on the cost of this to the ultimate consumers and raise housing costs. Given their recent practice of increasing fees, I think that is something we really need to protect against.

Second, as representing those who would be building these affordable housing units, there has to be some sort of a safeguard to ensure that even in a bad year, the fund doesn't go down to zero and projects that are in the pipeline and have already had significant dollars put into them aren't cut off. So that has to be examined very carefully to make sure that there is going to be a continuity of effort and that this program is not interrupted by bad years.

Senator CARPER. OK. Good point. Thanks. Other thoughts, please.

Mr. SHEAR. I will first thank you for so well summarizing the position we have on the single regulator, which we have had for some time now. So I will thank you for just——

Senator CARPER. You guys have been staying on message for some time. Good work.

[Laughter.]

Mr. SHEAR. Thank you. When we have talked about it among ourselves—this is not an evaluation we have conducted but we have discussed the idea of a broader based fee, in terms of basis points applied to the enterprises' book of business. If you are going to have an Affordable Housing Fund, you are moving in a direction such as the Federal Home Loan Bank's Affordable Housing Program, and there is a cost of doing that. You have to recognize this cost in setting the numeric goals. It would change the paradigm.

But we like the broader-based fee based on the idea that we don't want to create incentives for the GSEs to change their—how much they use retained portfolio versus securitization to achieve certain targets.

Senator CARPER. All right. Thank you. Yes, sir?

Mr. MALTA. Thank you, Senator. We, too—REALTORS® would have concerns if it were done on a per transaction basis for obvious reasons, as the speakers have already spoken on. Thank you.

Senator CARPER. Thanks very much.

The other question I want to ask, and I will ask you just to be real brief in responding on this point, the same general subject. The issue is Affordable Housing Fund. In my State, and I am sure in Rhode Island and other States, we benefit from the good work of, in Delaware, the Pittsburgh Bank, but we have these Federal Home Loan Banks around our country. They contribute, I think, 10 percent of their net income to affordable housing. I think they actually have a repository into which, or a trust fund into which the money actually flows.

My question is, if we are going to have an Affordable Housing Fund that goes out of Fannie Mae and Freddie Mac, and my hope is that we will—I am strongly supportive of Senator Reed's efforts generally in that direction—but if we are going to have it, should we simply—do we need to reinvent the wheel? Do we need to come up with another trust fund in which to be a repository, in this case for monies that might flow from activities of Fannie Mae or Freddie Mac, or should we simply use the repository that is already there?

Yes, ma'am.

Mr. HOWARD. May I get to that?

Senator CARPER. And I would ask you to be brief, everyone to just be brief because my time has expired.

Mr. HOWARD. We certainly support and think that the Affordable Housing Program that the Federal Home Loan Banks has developed is a good one and it is a step, but it really doesn't go far enough. These grants from the Affordable Housing Fund amount to about $5,000 on a per unit basis. It is very, very shallow from a subsidy point of view, does not produce that much with the way of deeply affordable housing, and the income standards are still very high.

I think what is important about the Affordable Housing Fund, the block grant program and the Capital Magnet Program, is that it is targeting very deeply, and that is something we have not had in these programs in many, many years.

Senator CARPER. Thank you. Let me hear from others, please.

Mr. QUINN. Senator, we are fine with the funds being there with the regulator. We want to make sure that it goes after—we are seeing a shortage of multi-family apartments, also, that serve the very lowest incomes. It is going to be people are moving from foreclosed homes back to this multi-family. They are going to be staying in those multi-family properties longer because it is going to be harder to qualify for a loan. So we want to see—the home program that you use now, we think is a great vehicle and we want to see it go to cities and States.

Senator CARPER. Thanks very much. Others, please.

Mr. MALTA. Senator, coming from California where these funds tend to get raided a lot, we would like to see whatever vehicle is best that protects those funds, that those funds go directly to what it was intended.

Senator CARPER. All right. Thank you. Anyone else? No? OK.

Senator Reed. Thank you all.

Senator REED. Thank you very much, Senator Carper. Senator Carper has been a relentless advocate for the GSE reform bill and a very effective one, and so if we—and I hope we do get it through. Much of the credit for keeping it moving goes to you, so thank you. Thank you very much.

I want to thank all the panelists not only for your testimony today, but your insights over several years in your professional capacities have been extremely helpful to me and also to the committee.

One point that I was thinking about, Senator Carper raised a very interesting line of questioning about how you assess a fee or a levy to support an Affordable Housing Trust Fund, and one of the concerns about that being passed through. But it raises a question of mine is, it is very difficult in a business when you know you have a cost or taxes not to think of ways to pass it on to your customers. The real question might be how easy it is to pass on or what percent you can pass on given these different transaction fees versus net income assessment.

So in that line, let us begin with you, Ms. Andrews, on that, to ask people, my sense is that any organization would try to pass on costs to consumers if they could get away with it, so the form of the assessment, that might be the critical issue.

Ms. ANDREWS. I agree. I don't think that that is really the critical issue. We know and we believe that whatever impact this will have, it will not be a material one on the shareholders. It is well within the range of the two agencies to absorb this and to do it in a way that really is not going to impact their stock, their shareholders, or their ability to capitalize themselves.

Senator REED. I guess, and I want to ask everybody else to respond, but to me, again, the most obvious would be to put some type of basis point levy on every transaction because it looks like a sales tax or excise tax or something and it could be attributed directly. That is why I think one of the—we were thinking more in lines of a levy on net income, which is less specific to individualized transactions.

Mr. Howard.

Mr. HOWARD. I guess, Senator, from my perspective, what this again is evidence of is the importance of having a regulator of safety and soundness as well as the mission regulator at one place talking with each other and they can make sure that the appropriate balance would be reached on how to raise the money and how to make sure at the same time it is not increasing costs of housing somewhere else in the market.

Senator REED. Thank you. Mr. Quinn, please.

Mr. QUINN. Senator, it is very difficult to hide an additional cost and not pass it through, but a fee on a transaction would be direct and would jump up.

Senator REED. Yes.

Mr. QUINN. We went to the portfolios. That is where they get their savings. We thought that was a direct——

Senator REED. No, I mean, the good news is the House has an Affordable Housing Fund component in their bill. We could add to that good news by passing legislation in the Senate. Then we would get to conference and we would have to have a very detailed discussion based upon a whole set of issues, and one which you have both highlighted is to what extent would this be passed on and inhibit activity of the consumers or the services of Fannie and Freddie, so I think this is a very fair point. But my hope is we have this discussion in conference and we resolve it.

Mr. Malta, do you have comments?

Mr. MALTA. Thank you, Senator. I would just be echoing the comments that were already made.

Senator REED. Mr. Shear.

Mr. SHEAR. I would be echoing the comments. A lot of times, the devil is in the details and we are not going to resolve it at this table.

Senator REED. No, but your insights are very, very helpful and I thank you for that.

One of the aspects of the proposal that I have made with respect to affordable housing is to provide 35 percent of the funds to Community Development Finance agencies to match with private funds, et cetera. Ms. Andrews, you are deeply engaged in the CDFI effort. Can you tell us how you would use it, how much funds you think you can leverage, and anything else you think is relevant?

Ms. ANDREWS. Sure, I would be delighted. One of the proposals that is on the table for this and actually is being worked on by one of our groups now, it is called Self-Help in North Carolina, is to create a pool of funds that would be leveraged through something like this that would be available for the purchase of foreclosed and abandoned property for the rehabilitation and stabilization of that property, and then to make those new properties available to very low-income people. So that is a great example of the kind of thing that we could do.

If I may, I will give you one more concrete example.

Senator REED. Sure.

Ms. ANDREWS. We have—my organization just in the last few weeks provided a $10 million loan to the Elva McZeal Apartments in Brooklyn, New York. This is a 142-unit building that is occupied entirely by very low-income families. Most of them are single female-headed households. We were able to take funds from our fund and then leverage in funds from the United Methodist Pension Fund that created a stable mortgage, a fixed rate, a 30-year mortgage that allowed this building to stabilize, and the mostly women, female-headed households, to become homeowners. That is another example of how we would leverage.

Senator REED. And the concept embedded in the legislation we are talking about is that funds flowing out to CDFIs would always have to be matched——

Ms. ANDREWS. Absolutely.

Senator REED [continuing]. And therefore, we get a bigger bang for the dollars that we are directing your way.

Ms. ANDREWS. Absolutely. We are, as a group across the country, on average, leveraging $19 of private money for every single dollar of Federal money that we get.

Senator REED. One other point in response to your discussions about acquiring foreclosed property, et cetera. I had a very interesting discussion with the head of our Rhode Island Housing Mortgage Finance Corporation and there is a real fear all across the country that these foreclosures are leaving properties abandoned which very quickly are being stripped of piping. So if we don't move dramatically, we are going to have to go ahead and rebuild affordable housing that has been destroyed through the foreclosure process. That is a very disturbing process, and so unfortunately, I think the funds like this would be very useful.

But I would invite any comments about this magnet funds. Mr. Shear, perhaps I will start with you. Have you had a chance to review this, or——

Mr. SHEAR. We have had some discussion of the Affordable Housing Fund along the lines of financing it, the need to have controls in place and the need to have the right incentive structure. We have also discussed how it might affect the paradigm of how the numeric goals might play out, but I don't have anything more specific than that.

Senator REED. Thank you. Mr. Malta, any comments?

Mr. MALTA. We supported similar legislation on the House side and we look forward to working with you in the future on what you are working on.

Senator REED. Thank you very much.

Mr. QUINN. The benefit of that single regulator is he can work with different people over time to see what is working.

Senator REED. You are absolutely right and I think that is one concept I think we are all keen on. The details, as we have talked about, are critical.

I would also echo your point, Mr. Quinn, about really the increased demand for multi-family housing. Many times, that is exactly what these local agencies are doing, as Ms. Andrews has pointed out in terms of that apartment complex in Brooklyn.

Mr. Howard, any comments?

Mr. HOWARD. Well, we always believe, Senator, that passing and giving the responsibility at the most local level of government is definitely the most effective way to get anything done. We would also like to point out that we firmly believe that there should be a competitive process by which the construction is awarded to the most cost-efficient professional means of building the affordable units.

Senator REED. Thank you very much. Good comments.

One final question and I would invite anyone if they wanted to comment about it, that part of the legislation we have proposed has new affordable housing goals which would direct Fannie and Freddie to serve, we hope more effectively, underserved markets, including some of those underserved markets of manufactured housing, affordable housing preservation efforts, subprime borrowers who are facing immediate foreclosure. We talked about CDFIs, rural markets. Is there anything in that list or additions that we should consider in terms of the goals of Fannie and Freddie? Mr. Shear, do you have a comment, or does anyone have a comment?

Mr. SHEAR. I think you have a very good list and I would just bring it back to basically our proposal and what has been echoed here. It is very important to have a regulator that can look at both sides of the issue in a very independent and a very sophisticated way and we would love to work with you and the committee in trying to move forward on that.

Senator REED. Thank you very much. Nancy.

Ms. ANDREWS. Yes. Senator Reed, one of the things—we agree with the list in the duty to serve language. We think that is a fine list and it is good. One of the things that you have done and that we endorse very much is to ensure that the goals pull out the deep targeting that we are looking for, that they look closely at very low-income and extremely low-income households. So we would encourage that.

Senator REED. Thank you. Mr. Quinn.

Mr. QUINN. I would echo the lower income on the affordable housing goals.

Senator REED. Thank you very much. Gentlemen and Ms. Andrews, thank you very much for your testimony. Your ongoing assistance and advice to us is very, very useful. Thank you.

Chairman DODD [presiding]. Thank you, Senator Reed.

Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. I want to thank all of you for your testimony. I think this is a——

Chairman DODD. Bob, if you want to come up and sit up a little closer, you don't have to feel that estranged from——

Senator CORKER. I have got my notes all spread out, but if we continue, I will move up right beside you and it will be a tremendous honor, but——

[Laughter.]

Chairman DODD. I want to keep you close here.

Senator CORKER. I understand, and I do, Mr. Chairman. I know that we sometimes have differing points of view, but I think it is all very, very constructive, and as I told you on the elevator going to vote, I think you have had some outstanding hearings and I am really honored to be on this committee. I think we are addressing some really, really important issues right now and I think these panelists and the ones we have had in the past have been just really constructive in that process.

Chairman DODD. Thanks.

Senator CORKER. I find it interesting that the markets create differing opportunities and differing problems as we move through the cycle. I know that Nancy has focused on making sure that people have affordable housing, and that is something that all of us need to focus on, there is no question. I know that as we have had this housing bubble, if you will, just a few years ago, we were really, really focused on just the high cost of housing. I know some of the testimony earlier was that it really—while in some ways, those who owned it were benefiting from a growth in equity, those who were just trying to get by were really having a difficult time.

So I just want to point out that we do have these dilemmas and sometimes we in the Senate and House try to focus on the problem, but in essence, the fact that housing prices are declining some, for those people who are financially struggling, that is a good thing. I just want us to keep that in mind. I mean, we have had an incredible increase in housing prices. Places like California basically cause middle-income people in some cases not to be able to afford housing. I just think as we move through trying to focus on this problem, we ought to keep those kind of things in perspective.

At the same time, I know there was some comment, and I am not totally familiar with Senator Reed's legislation, that a way of providing affordable housing would be to charge 4.2 basis points on transactions to create the funds necessary for low-income housing. I would just like for some of the market-based folks that are dealing with other areas—I guess that, in fact, would inflate the cost or the loan cost to all borrowers across the country, is that correct?

Mr. HOWARD. [Nodding head.]

Senator CORKER. OK. And I think, and while I absolutely applaud the efforts to do that, and I probably wouldn't be in the Senate today if it hadn't been for my involvement civically in similar kinds of issues, as far as the market-based folks are concerned, is that the best way to deal with it, meaning that we basically are jacking up, if you will, the cost for people all across America to borrow money and own homes? Is that the best way to deal with affordable housing, or would a more surgical approach, where we allocate resources in a different way, would that be a different—of course, all taxpayers, in fact, pay for that, too. I am just wondering if there is any competing philosophy there as it relates to how we deal with low-income housing.

Mr. MALTA. Senator, there is no best way to tackle the affordable housing issue. It is a multi-prong approach that it is going to take to deal with that issue and to get us through this crisis and beyond.

We believe that we have got to get the market stabilized, and that is why we are coming out so very strongly in relation to our comments in relation to the jumbo market, et cetera, which does impact the affordability overall. We are not just talking luxury properties. We are talking about the market as a whole. So, again, the fund is one component of many prongs that you need to move this whole legislation forward and work on it.

Mr. QUINN. It is exactly that, one component that doesn't exist today. If it is targeted to low- and moderate-income people, it will be excellently received out in the marketplace. It is very hard to distinguish a tax, a cost. It is going to raise the cost of financing, and to what degree. But we echo also the message to the capital markets today for passing this legislation could go a long way to sort of free up some gridlock all across the capital markets. There are a number of different things you can do for foreclosures and to stir up the economy. You have passed the bills up to date, but this is just one major signal. I can't underestimate that enough.

Ms. ANDREWS. Senator Corker, if I may, this is a tax, if you will, that amounts to about a half-a-penny. It is less than a half-a-penny and it grows and it shrinks based on the strength of business. It can be stopped. It can be ceased at the point that there is a financial problem that the GSEs face. So if we are trying to think of how do we equitably do this, this approach is as good, I think, as almost anything else that we can come up with.

Mr. HOWARD. Senator, I would agree with that. I guess my underlying point right now would be, however, that the housing economy is in such bad shape that adding any cost right now is a potentially troubling situation. If the GSEs were going to keep the costs themselves and keep them in-house, that is one thing. But as was pointed out by Senator Reed, that almost never happens in business, and right now, those who are trying to finance the construction of new homes at every level of the market are struggling mightily, and adding any cost right now is something that we would be concerned about.

Senator CORKER. What I would like to do then is follow that line of thinking, and that is I know that each of you have focused on some of the components in this last stimulus package, and those were the ones that actually cost nothing immediately. I mean, in essence, we raised the GSE limits and that is what—I just would like to point out, that is what all of you have focused on. The other part of sprinkling money around America and getting people to spend it obviously was a huge part of the cost and yet does nothing to really focus on the crisis, if you will, or the correction or whatever we want to call it that we are dealing with right now.

So I know we are going to be dealing with some other legislation and since we have this awesome panel of folks here to talk about it, what are the things that surgically deal with this problem? We have got such a collage of ideas out there, and I actually would like to focus first on the home builders. Instead of having a 2-year loss carry-forward, you go back 5 years. It is a cost to the Treasury of

$17 billion, OK. I know Nancy has a lot she could do with $17 billion, and all of you do. It is a $17 billion cost, and yet it does absolutely nothing, if you will, as it relates to dealing with the credit issue.

That is what I have been trying in my own one of 100 focus to do, is to make people realize that it is going to do nothing whatsoever other than shore up home builders that are in trouble. It shores up every industry, but that is really not the problem today. I mean, the problem is that we have a credit issue, and since the home builders are the ones who are going to benefit from that most of this group, anyway, I would love for you to respond.

Mr. HOWARD. Well, sir, I guess it would be difficult for many home builders to be able to avail themselves of stability in the credit markets if they go out of business, and unfortunately, the circumstances are such that many home building concerns throughout the nation, in fact, in your State as well as others, are in a position where being able to carry back their net operating losses, or carry forward their net operating losses would enable them to infuse capital into their own businesses and keep people employed and keep businesses open.

You are right, it doesn't address the credit issue immediately, but it keeps people at work and in business and that is why we think it is important, and that is how dire this situation is for the home building concerns around this country.

Senator CORKER. I guess all the framers and plumbers and electricians and all that would just deal with the next home builder that was solvent, is that not correct? I mean, it is not like—when you talk about the employment issue, home builders don't really employ that many people. It is all the subcontractors that actually work under that umbrella——

Mr. HOWARD. Senator, as one who just went through the process of building my home and is very intimately involved in the business, as much as I applaud the work of the subcontractors, you need a general contractor to oversee everything. If they go out of business, it will make the home construction process significantly more difficult.

Senator CORKER. Yes, and I am certainly not saying that you can do that without a general contractor. So you would see that as spreading that net loss carry-forward out to every industry in America, not just home builders, every——

Mr. HOWARD. That is correct, sir.

Senator CORKER. You understand, I mean, that is every company in America——

Mr. HOWARD. I do understand that——

Senator CORKER [continuing]. And that is a $17 billion expenditure. You think that is an important factor to solving the credit problem that we are dealing with today?

Mr. HOWARD. I don't think it is an important factor to solving the credit problem, sir. I think it is an important factor to keep many of America's small businesses open with their doors open, and Senator, not to be disrespectful, but I had not heard $17 billion. I thought it was a $7 billion cost.

Senator CORKER. Seventeen billion was the number we were given yesterday.

All right. There is another, I guess, another piece of this that is the $10 billion—expanding the State governments' ability to use their own bonds, tax-free bonds, to help people with subprimes. It is a $1.7 billion cost. I am wondering if anybody might comment on the efficacy of that particular proposal, which does seem like it at least gets it down at a level where people actually know what is happening on the ground and might actually deal with people they know, but I would love for you all to respond to that.

Mr. QUINN. Senator, we support that wholeheartedly. I think it does two things. It gets capital out in the markets and gets it into many States. There are three States in the Upper Midwest, California, Florida, Nevada, that are having the more serious problems. So it is a very targeted solution. So we applaud that.

Senator CORKER. So we have a targeted solution that costs $1.7 billion that actually addresses the credit problem. We have a $17 billion issue that helps some home builders—and by the way, I understand the problem, but it also scatters throughout the entire economic base in our country that has nothing whatsoever to do with this credit issue.

I think you may have a comment.

Mr. MALTA. In the same, the National Association of REALTORS® came out and supported the mortgage revenue bonds, as well.

Senator CORKER. So surgically, that, in fact, does help us. What I find interesting about this entire stimulus issue is that there are so many things that we can do legislatively that cost the taxpayers almost nothing, and I am talking about the GSE jacking the rates up, creating some freedom through the FHA modernization, the $1.7 billion—which is a lot of money, don't get me wrong, but compared to the $160 billion we just spent and what is now being proposed—very, very small amounts of money and some legislative freedoms can do huge things to solve this problem versus, if you will, spending billions and billions and billions that have nothing whatsoever to do with the problem.

I would just like some expansive conversation. Was there another comment? Yes, Nancy.

Ms. ANDREWS. I did want to say with a little humor that I feel like I am offering you the best deal on the block. We are talking about a program that is 4.2 basis points. It is about $800 million a year. We are going to leverage it 19 times over. The stimulative effect of that is very profound. It just pales by comparison with the other numbers that you are describing.

Mr. HOWARD. I guess, Senator, from the perspective of our organization and our industry, which as recently as 2 years ago was 16 percent of the GDP and is now about 14 percent, a 2 percent drop-off, we are feeling that we are heading precipitously toward a recession, that there are two different philosophies on how to address it, how to stimulate the economy. One is do you stimulate the consumers, as the bill that just passed did, or do you look at the industries, and if home building concerns are important to the economic health of this country, then it would seem to us that keeping them viable is equally as important.

And so I think you have to debate and it is really the decision of you all on that side of the dais to determine what is the most effective way to do it. But we can make a very solid case for net operating losses, for mortgage revenue bonds, even for the 1975–76 President Ford tax credit at this point in time, and we believe that the situation is so dire that any and all of these things need to be discussed, but ultimately that some action needs to be taken very, very soon.

Mr. QUINN. We are with him on the tax credit idea, new homes and homes coming out of foreclosure.

Senator CORKER. The Johnny Isakson—I think that is a $13 billion—it is somewhere from a $9 to $13 billion cost, and that everybody at the table agrees is something that ought to occur.

Mr. MALTA. Yes.

Senator CORKER. OK. Mr. Chairman.

Chairman DODD. Well, thank you very much, Senator.

A couple of other items were included in this idea. One was the Community Development Block Grant approach, targeted resources to go to counties and municipalities to assist county supervisors and mayors and others where you had foreclosed properties, to mitigate against the adverse effects of that, not as a revenue sharing program but as some assistance. The counseling idea, Senator Kit Bond and I offered $180 million back some months ago and resources to go to various counseling organizations. We are told there is a greater need for that.

Again, Senator Corker's point, I would say that there are three clusters of issues here that we are grappling with. There are a lot of moving parts in all of this. One is what do we do to make sure that this doesn't happen again, and there are a lot of ideas. We have introduced some legislation. I have talked with Kieran and his group and others about various things that we have to do, and we are going to get to that. But at this juncture here, that isn't as immediate an issue as is the current, I call it crisis, problem. So that is the first cluster.

The second cluster is what can we do to minimize the impacts of this on people who are being adversely affected by it, those who are facing foreclosure, the costs to communities and the like to try and mitigate. It doesn't deal with the problem, it just deals with the problems that have been created by the problem, in a sense.

And the third cluster is obviously what do you do about the problem, in a sense, of loosening up this credit, looking at this whole issue of moving again. That is the third group of issues, and the most important one in many ways, because if you could help solve that—and I don't think the two are entirely separate. I think there is a correlation between building the kind of confidence and optimism, that intangible quality that has an awful lot to do with the issue of people once again taking risks, stepping up to the plate. I don't want to overestimate the importance of that, but I think to sort of stovepipe it and just say these are totally separate issues, I think is to miss the point.

While I agree with Senator Corker, some of these things don't really address the issue of how we get this back on track again, I think there is a value in that and in providing some level of confidence and hope. And obviously to the extent you can keep people in their homes can make a huge difference to me. I mean, that is just dealing with the problem. I would much rather keep someone in their home than the question of having to offer a $13 billion tax credit to provide someone with the opportunity to buy that foreclosed property.

It seems to me to the extent we can minimize this cost—and when we tried this idea in the past of actually setting up a corporation to take highly distressed mortgages and buy them in bulk and then offer them at a discount cost and a fixed rate over a period of time, the Federal Government made $10 billion off that program. It was not neutral, it was a money maker. Now, they could argue whether or not that would work today given the differences that existed earlier, but like that idea or the one that Chairman Bernanke talked about yesterday, but the idea that we would try and put people in a position who are owner-occupied—I am not talking about the speculating community, but to give that constituency an opportunity to remain in their homes with a cost that they could afford.

My concerns are that right now, we are talking about people who have had credit problems in the past, are in some trouble, but it is beginning to move into a more secure constituency, as well. The estimates are that we can be starting to talk about not 2.5 million homes, but as many as 40 to 50 million homes that are underwater or could be underwater in the sense of what the value of that property is and the cost of that mortgage. And then if these problems create larger economic issues, the ability of that individual to sustain those payments until the value of that property begins to exceed the cost of that mortgage get more difficult. Then the problem becomes a lot larger than 2.5 million. And, of course, when you have a 10 to 15 percent decline in housing values, there are some reports that indicate there is a $2 trillion effect in our economy, and those are staggering numbers.

So again, I am, as you can sense, I have a sense of frustration in trying to get some ideas on how we deal with this and I am certainly going to get the FHA and the GSE bill, and Kieran, I don't disagree, I think those are important issues to send, but they go back in a sense to Senator Corker's point. To some degree, FHA will provide some help, but I think it would be a mistake to exaggerate what FHA reform is going to do here. I am worried that people are going to think that is going to solve the problem. It doesn't. It can offer some amelioration to it, but it isn't going to solve the underlying issue.

So this has been a great panel and obviously important. I just have two quick questions I want to raise regarding the GSEs.

There have been some who have suggested that instead of having a singular regulator, we ought to look at like the SEC model or FDIC. Is there any appeal to that, or is it far better to—Mr. Shear, do you have a notion on that at all, whether you would like the—I think the single regulator is what people are talking about. That makes more sense. Is there any appetite for a board like the SEC or FDIC?

Mr. SHEAR. No.

Chairman DODD. No?

Mr. SHEAR. No, we do not favor having regulatory agency, with a board, that shares oversight responsibilities with other regulatory entities. With respect to whether the single regulator should have a board or director structure, the director model has certain advantages while a board structure has others. As stated in our written statement, we favor a single regulatory agency with either a board or what we call a hybrid board structure where a director is in charge of the agency.

Chairman DODD. Ms. Andrews, any——

Ms. ANDREWS. No, I am sorry. That is not an area——

Chairman DODD. And then whether or not you would be subject to—the regulator would be subject to the appropriation process for its funding. Any thought on that one at all? That gets rather into the weeds here, but have you given any thought to that? I see you shaking your head.

Ms. ANDREWS. No, I have not considered that.

Chairman DODD. All right.

Mr. SHEAR. We have considered it and there can be some tradeoffs involved, but we see many of the benefits that other financial regulators have had being outside of the appropriations process. So we are very concerned about HUD not only being in the appropriations process, but not being paid for by the GSEs, and there are certain benefits in terms of independence, the ability to plan, a number of other benefits of removing the GSE regulator from the appropriations process.

Chairman DODD. All right. Well, those are the kind of issues when we start marking up a piece of legislation, you can imagine we will have some debates about some of these matters.

I am told by staff that the $10 billion number that I mentioned a moment ago that the Federal Government made as a result of a similar program tried a number of years ago may be an inflated number, but I may be right and you may be wrong, so we will check that out.

[Laughter.]

And the Senator is always right.

[Laughter.]

We will revise and extend the remarks a little later, as we used to say.

Senator Carper, do you have any additional questions?

Senator CARPER. The Senator is always right, except at home with our spouses.

[Laughter.]

My staff was good enough to provide a list of four items where we are sort of hung up. I mentioned, Mr. Chairman, I mentioned at the beginning of my questioning of the panel all the areas where we found common ground with one another and I think with the administration. There are, as I understand it, about four areas where we may still be looking for consensus.

One of those deals with the issue of new products and the——

Chairman DODD. The approval of new products.

Senator CARPER. The approval of new products.

Chairman DODD. I raised that earlier.

Senator CARPER. I want to go back to that just for a moment, if I can.

Chairman DODD. Can I just say, by the way, I mean, I should have made the point earlier, in your testimony, the list on page nine of your testimony, I think is a very good list, by the way. As

Chairman here, I am very encouraged by those series of suggestions. I think they are very sound. Sorry.

Senator CARPER. Was that directed to Mr. Shear?

Chairman DODD. Yes.

Senator CARPER. The one and only Billy Shear?

[Laughter.]

All right. Thank you for an excellent list. One more thing to be grateful for.

Product approval. The House, a I understand the House proposal, if one of these GSEs comes up with—now this would just be for Fannie Mae or Freddie Mac. This would not, as I understand it, it would not pertain to the Home Loan Banks. But if Fannie Mae or Freddie Mac would come up with a new product idea, they have to go through a process where they lay out an idea, maybe there is a 30-day notice or some kind of comment period, a 30-day comment period. It is a process that can take an extended period of time.

I think Senator Sarbanes when he was our Chair or Ranking Member, I think he had a different approach and that was to say that for existing products, that changes for existing products wouldn't have to go through the notice, the approval process for changes to existing products, but for new products, they would have to go through this kind of notice and comment period.

And then there is the idea that a third alternative would be basically to treat, for new products, treat Fannie Mae and Freddie Mac much as the Home Loan Banks are treated now, and that is they don't have to go through the extended notice and comment period.

Chairman Dodd may have raised this when I was out of the room, I ran to vote earlier in the hearing, but where is a reasonable compromise on this and why? Anybody?

Mr. SHEAR. I will try to repeat my answer from earlier. It is important—I don't think anybody is saying that if there are changes in underwriting or other approaches that that is a new product, but there has to be a lot of attention paid and a reasonable compromise on how you define a new product or activity, and it is important to balance the need to keep Fannie Mae and Freddie Mac consistent with their charters and contributing to the housing mission. There also is a need to be able to adapt products that might be consistent with that vision in a reasonable amount of time. So a lot of it, I think, gets into how do you define a new product or a new activity.

Senator CARPER. All right.

Mr. QUINN. Senator, we are very focused on giving the regulators sort of broad latitude to define a new program. Clearly, if it is supporting liquidity in the secondary market, we think he can recognize that very clearly and I think he can also agree when it is interfering with the primary market and the competitive nature of that market. So we give in many cases, and certainly on portfolio caps, we want to give the regulator broad latitude in both areas.

Senator CARPER. Some other thoughts, please? Yes, sir?

Mr. MALTA. Senator, yes. Our concerns are more broad. We just don't want to see them derailed from being able to do their mission, creating an undue process for them that would not—or would stifle them from being able to create new programs in the marketplace, especially now when it is so great is the need.

Senator CARPER. Anyone else?

[No response.]

Senator CARPER. One of the other differences of opinion that we appear to have deals with capital authority, and I think in the House bill, Mr. Chairman, I think there is something called a snap-back provision. I don't know if that rings a bell with you. But I think the House bill gives a regulator the authority to unilaterally raise the minimum capital standard requirement, but requires the capital return back to the normal level after some kind of incident of concern has passed and they call it a snap-back provision. I understand there are some who don't like that, maybe some on this committee, who don't like the snap-back provision.

I was trying to think through and talk it over with my staff member behind me, trying to think through what might be a reasonable alternative or compromise there. The snap-back could be, instead of for a limited period of time, it could be stretched out over a longer period of time, so it would be a slow snap-back, but there might be some other ideas, as well.

Does anybody have a thought on how to thread the needle on this particular difference of opinion? Mr. Shear.

Mr. SHEAR. I will go back to how we envision this regulator. It would be a regulator that would have broad authority. It would be subject to not just Congressional oversight, but also to promulgating rules and regulations through a well-defined public comment process. We think that those types of considerations basically should be left to the rulemaking process surrounding the authorities given to the new regulator.

Mr. QUINN. Senator, OFHEO had to go to cease and desist orders after the last crisis. A bank-like regulator has much more flexibility to raise capital or lower capital requirements. That is the model we have been espousing, also.

Senator CARPER. Yes.

Mr. HOWARD. And we like the snap-back provisions that are in the House bill, but if it had to go to something less——

Senator CARPER. Less heavy? Less snappy?

[Laughter.]

Mr. HOWARD [continuing]. Less snappy, then I guess we would be in favor of a periodic review by the regulator and possibly even by Congress to make sure that over-zealous regulators aren't impeding the GSEs' ability to achieve their mission. And again, going back to Mr. Shear's comments, a regulator that has responsibility for both safety and soundness and the housing mission, I think will go very far toward achieving that.

Senator CARPER. OK. All right. Mr. Chairman, this has been a good hearing and I applaud you for bringing this group together and putting this issue on the fast track. Thank you so much.

Chairman DODD. I thank you, and I think we have sort of exhausted. When you spend 10 minutes on snap-back, I think we have kind of reached a——

[Laughter.]

We have really gotten down to the weeds on this one, I will tell you. This will be the last hearing we are going to have on the GSE issue here and we are going to try and mark up a bill here pretty quickly, if we can. My hope is we will use some good common sense here.

I know there are those who, frankly, have been hostile to the GSE whole idea, and I am not one of those. I agree with those of you here. I think had we, in fact, adopted some of the legislative ideas earlier, we might be in a very different and more difficult situation today. It is one of those things where taking a little time—time can be an ally, and thinking things through, and in this case here, had we acted expeditiously on this matter earlier, the problem today, as serious as it is, I think it would be a more serious one. The liquidity provided by the GSEs here has been a lifesaver, at least at this point. So we don't want to miss that opportunity and understand the value and the mission statement of Fannie and Freddie and the Home Loan Banks.

I am very grateful to all of you for being here this morning, grateful to Senator Shelby for his work he has done as Chairman of this committee in this area, as well, and to let you know that both on FHA and this issue, we are going to try and get something done as soon as we can. But again, we are looking for ideas, as well, on how to deal with the problem of keeping people in their homes if we can, those who deserve to be kept in their homes and can have the ability to do that.

And the affordable housing issue, Ms. Andrews, you should know, I think you heard up here there is a lot of interest in it and you make a strong and wonderful case. That constituency is very lucky to have you as an advocate. You make an eloquent case for the issue.

Senator CORKER. Mr. Chairman, if I can make a comment——

Chairman DODD. Yes, Senator Corker.

Senator CORKER [continuing]. Since I know you are going to hit the gavel here soon, I, too, would like to thank the panel. I think that Senator Carper said there is actually a lot of agreement that we really need to—it looks like to me we just need to move ahead and solve this particular issue as far as the regulation and increased limits. I want to thank the panel for their testimony.

To the Home Builders, I do want you to know that I are one, if you will. I made a living being a general contractor and I meant no disrespect as far as what you do. You are the same group that I have worked with for years in many different capacities who generally wants government off your back and really hates, if you will, so many of the things that we do with such a broad brush.

My attempt here is really just to figure out a focused way, if you will, to deal with the home issues instead of such a broad-brush approach, and I hope you understand that. I think in many other ways, you respect that, but in this particular issue, I know it hits you right in the heart. I just have been a little disappointed in the way we have tried to stimulate the economy over the last month and I am trying to bring a narrower focus to that, so I just want you to understand that but I thank you for what you do.

Mr. HOWARD. Thank you, Senator. We do understand.

Senator CORKER. OK.

Chairman DODD. Thank you, Senator Corker. Senator Carper, thank you.

The committee will stand adjourned.

[Whereupon, at 12:06 p.m., the hearing was adjourned.]
[Prepared statements supplied for the record follow:]

United States Government Accountability Office

GAO

Testimony
Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

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HOUSING GOVERNMENT-SPONSORED ENTERPRISES

A Single Regulator Will Better Ensure Safety and Soundness and Mission Achievement

Statement of William B. Shear, Director
Financial Markets and Community Investment

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Highlights

Highlights of GAO-08-563T, a testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

Why GAO Did This Study

The housing government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLBank System), play a critical role in the nation's housing finance system. However, concerns exist that the fragmented federal oversight structure for the GSEs is not well positioned to help ensure that they operate in a safe and sound manner and fulfill their housing missions.

This testimony provides information on the GSEs' missions and risks, the current regulatory structure, and proposed regulatory reforms.

To prepare this testimony, GAO relied on a substantial body of previous work and updated its analysis in light of recent events.

What GAO Recommends

GAO recommends that Congress establish a single regulator that is equipped with adequate authorities to fully oversee GSE activities and governed by a board or hybrid board structure.

To view the full product, including the scope and methodology, click on GAO-08-563T. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

March 6, 2008

HOUSING GOVERNMENT-SPONSORED ENTERPRISES

A Single Regulator Will Better Ensure Safety and Soundness and Mission Achievement

What GAO Found

While the GSEs provide certain public benefits, they also pose potential risks. Fannie Mae and Freddie Mac's primary activity involves purchasing mortgages from lenders and issuing mortgage-backed securities that are either sold to investors or held in the GSEs' retained portfolio. The 12 FHLBanks traditionally made loans to their members and more recently instituted programs to purchase mortgages from their members and hold such mortgages in their portfolios. While not obligated to do so, the federal government could provide financial assistance to the GSEs, if one or more experienced financial difficulties, that could result in significant costs to taxpayers. Due to the GSEs' large size, the potential also exists that financial problems at one or more of the GSEs could have destabilizing effects on financial markets.

The current housing GSE regulatory structure is fragmented and not well equipped to oversee their financial soundness or housing mission achievement. The Office of Federal Housing Enterprise Oversight (OFHEO) is responsible for safety and soundness oversight of Fannie Mae and Freddie Mac while the Federal Housing Finance Board (FHFB) is responsible for safety and soundness and mission oversight of the FHLBank System. Both regulators lack key statutory authorities to fulfill their safety and soundness responsibilities as compared to the authorities available to federal bank regulators. For example, OFHEO and FHFB are not authorized to limit the asset growth of housing GSEs if capital falls below predetermined levels. Moreover, the Department of Housing and Urban Development (HUD), which has housing mission oversight responsibility for Fannie Mae and Freddie Mac, faces a number of challenges in carrying out its responsibilities. In particular, HUD may not have sufficient resources and technical expertise to review sophisticated financial products and issues.

Creating a single housing GSE regulator could better ensure consistency of regulation among the GSEs. With safety and soundness and mission oversight combined, a single regulator would be better positioned to consider potential trade-offs between these sometimes competing objectives. To be effective, the single regulator must have all the regulatory oversight and enforcement powers necessary to address unsafe and unsound practices, respond to financial emergencies, assess the extent to which the GSEs' activities benefit home buyers and mortgage markets, and otherwise ensure that the GSEs comply with their public missions. To ensure the independence and prominence of the regulator and allow it to act independently of the influence of the housing GSEs, this new GSE regulator should be governed by a board or hybrid board structure.

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to participate in today's hearing to discuss federal oversight of the housing government-sponsored enterprises (GSEs), namely Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLBank System). The housing GSEs continue to play a critical role in the nation's housing finance system and this committee, with input from a number of entities, is assessing the contributions the GSEs may be able to make to address currently distressed housing market conditions. However, as you know, the housing GSEs, which are large and complex organizations with more than $6 trillion in outstanding obligations, also pose potentially significant risks to taxpayers. When Comptroller General Walker testified before this committee in April 2005, he stated that the fragmented federal regulatory structure for the housing GSEs was not well positioned to help ensure that they operate in a safe and sound manner and thereby limit such risks.[1] Further, he stated that the fragmented regulatory structure did not provide adequate assurance to Congress and the public that the GSEs were fulfilling their critical housing missions. As the Comptroller General testified, and I plan to emphasize today, the establishment of a single federal regulator with adequate authorities to oversee all housing GSE activities is critical to helping ensure that the housing GSEs' financial soundness is secure while they continue to provide opportunities to American homeowners.

To assist the committee in its oversight of the housing GSEs and their regulation, my testimony today is divided into two sections. First, I will provide an overview of the GSEs and their missions, identify the risks they pose to taxpayers and the financial system, and describe the current regulatory structure, which is divided among the Office of Federal Housing Enterprise Oversight (OFHEO), the Department of Housing and Urban Development (HUD), and the Federal Housing Finance Board (FHFB). Second, I will identify deficiencies in the current regulatory structure and discuss how a single regulator that is endowed with adequate legal authorities and governed by a board or hybrid board structure is, in our view, the best potential means to help ensure that the GSEs meet their housing-related missions while doing so in a safe and sound manner.

[1]See GAO, *Housing Government-Sponsored Enterprises: A New Oversight Structure Is Needed*, GAO-05-576T (Washington, D.C.: Apr. 21, 2005).

To prepare for this testimony, we relied heavily on a substantial amount of work that we have done on the housing GSEs and their regulatory oversight in the past (see Related GAO Products), and we also reviewed our historical positions in light of recent events. We conducted this work in Washington, D.C. in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Overview of the Housing GSEs, Their Risks, and Regulatory Structure

I would like to begin my testimony by briefly describing the missions and activities of each of the GSEs, and the risks they pose to taxpayers. Then I will describe the current GSE regulatory structure.

The Housing GSEs Share Similar Missions

Fannie Mae and Freddie Mac's mission is to enhance the availability of mortgage credit across the nation during both good and bad economic times by purchasing mortgages from lenders (banks, thrifts, and mortgage lenders), which then use the proceeds to make additional mortgages available to home buyers. Most mortgages purchased by Fannie Mae and Freddie Mac are conventional mortgages, which have no federal insurance or guarantee. The companies' mortgage purchases are subject to a conforming loan limit that currently stands at a maximum of $729,750.[2] Although Fannie Mae and Freddie Mac hold some mortgages in their portfolios that they purchased, most mortgages are placed in mortgage pools to support mortgage-backed securities (MBS). MBS issued by Fannie Mae or Freddie Mac are either sold to investors (off-balance sheet obligations) or held in their retained portfolios (on-balance sheet obligations). Fannie Mae and Freddie Mac guarantee the timely payment of principal and interest on MBS that they issue.

[2]The Economic Stimulus Act of 2008 enacted a temporary increase in the conforming loan limit. For mortgages originated between July 1, 2007, and December 31, 2008, the loan limit for an area will be the greater of (1) the existing limit of $417,000 or (2) 125 percent of the area median home price, not to exceed a ceiling of 175 percent of the statutory limit, or $729,750.

The 12 FHLBanks that constitute the FHLBank System traditionally made loans—also known as advances—to their members (typically banks or thrifts) to facilitate housing finance and community and economic development. FHLBank members are required to collateralize advances with high-quality assets such as single-family mortgages. More recently, the FHLBanks initiated programs to purchase mortgages directly from their members and hold them in their retained portfolios.[3] This process is similar to Fannie Mae and Freddie Mac's traditional business activities, although the FHLBanks do not have the authority to securitize mortgages.[4]

The activities of the housing GSEs generally have been credited with enhancing the development of the U.S. housing finance market. For example, when Fannie Mae and the FHLBank System were created during the 1930s, the housing finance market was fragmented and characterized by regional shortages of mortgage credit.[5] It is widely accepted that the activities of the housing GSEs helped develop a unified and liquid mortgage finance market in this country.

Housing GSE Activities Involve Significant Risks

While the housing GSEs have generated public benefits, their large size and activities pose potentially significant risks to taxpayers. As a result of their activities, the GSEs' outstanding debt and off-balance sheet financial obligations total more than $6 trillion. The GSEs face the risk of losses primarily from credit risk, interest rate risk, and operational risks.[6] Although the federal government explicitly does not guarantee the obligations of GSEs, it is generally assumed on Wall Street that assistance would be provided in a financial emergency. In fact, during the 1980s, the federal government provided financial assistance to both Fannie Mae and the Farm Credit System (another GSE) when they experienced difficulties

[3] Mortgages purchased by the FHLBanks contain some lender-provided credit enhancements.

[4] Securitization is the process of aggregating similar financial instruments, such as loans or mortgages, into pools and selling investors securities that are backed by cash flows from these pools.

[5] Freddie Mac was established in 1970.

[6] Credit risk is the possibility of financial loss resulting from default by homeowners on housing assets that have lost value; interest rate risk is the risk of loss due to fluctuations in interest rates; and operational risk includes the possibility of financial loss resulting from inadequate or failed internal processes, people, and systems or from external events.

due to sharply rising interest rates and declining agricultural land values, respectively.

More recently, the housing GSEs have experienced a variety of operational and financial challenges, some of which are described below:

- Starting in 2003, first Freddie Mac and then Fannie Mae were found to have engaged in misapplication of relevant accounting standards and earnings manipulation. The GSEs also misstated their incomes by billions of dollars. Consequently, OFHEO required Fannie Mae and Freddie Mac to develop capital restoration plans and both GSEs are still operating under regulatory agreements, which require improvements in their operations.
- According to FHFB, some FHLBanks did not embrace and implement corporate governance and risk management tools necessary for their complex and evolving operations, which resulted in operational and financial challenges. In 2004, FHFB entered into supervisory written agreements with the FHLBanks in Chicago and Seattle, which required a variety of operational improvements. FHFB terminated the written agreement with the Seattle bank in January 2007. FHFB also entered into a related agreement with the Chicago bank in October 2007.
- Fannie Mae reported that rising mortgage defaults and falling home prices contributed to a $3.6 billion loss for the company in the last quarter of 2007. The GSE predicted that housing prices will continue to fall and that its financial performance will deteriorate further. Similarly, Freddie Mac reported a loss of about $2.5 billion for the same period, of which approximately $2.3 billion is attributed to losses on derivative trades.

The GSEs also pose potential risks to the stability of the U.S. financial system. In particular, if Fannie Mae, Freddie Mac, or the FHLBank System were unable to meet their financial obligations, other financial market participants depending on payments from these GSEs in turn might become unable to meet their financial obligations. To the extent that this risk, called systemic risk, is associated with the housing GSEs, it is based primarily on the sheer size of their financial obligations. For example, as discussed in OFHEO's 2003 report on systemic risk, if either Fannie Mae or Freddie Mac were to become insolvent, financial institutions holding the enterprise's MBS could be put into a situation where they could no longer rely on those securities as a ready source of liquidity.[7] Depending on the response of the federal government, the financial health of the banking segment of the financial services industry could decline rapidly, possibly leading to a decline in economic activity. As another example, derivatives counterparties holding contracts with a financially troubled GSE could realize large losses if the GSE were no longer able to meet its obligations. If such an event were to occur, widespread defaults could occur in derivatives markets.

Housing GSE Regulatory Structure Is Divided among OFHEO, HUD, and FHFB

The current regulatory structure for the housing GSEs is divided among OFHEO, HUD, and FHFB, as described below:

- OFHEO is an independent office within HUD and is responsible for regulating Fannie Mae and Freddie Mac's safety and soundness. OFHEO oversees the two GSEs through its authority to examine their operations, determine capital adequacy, adopt rules, and take enforcement actions. Although OFHEO's financial plans and forecasts are included in the President's budget and are subject to the appropriations process, the agency is not funded with tax dollars. Rather, Fannie Mae and Freddie Mac pay annual assessments to cover OFHEO's costs.

- HUD is responsible for ensuring that Fannie Mae and Freddie Mac are accomplishing their housing missions. HUD is to accomplish this responsibility through its authority to set housing goals and review and approve new programs, and through its general regulatory authority. HUD is funded through appropriations.

- FHFB is responsible for regulating the FHLBank System's safety and soundness as well as its mission activities. The agency has a five-member board, with the President of the United States appointing four members—each of whom serves a 7-year term—subject to Senate approval. The fifth member is the Secretary of HUD. The President also appoints FHFB's chair. Like OFHEO, FHFB carries out its oversight authorities through examinations, establishing capital standards, rule making, and taking enforcement actions. FHFB is funded through assessments of the 12 Federal Home Loan Banks and is not subject to the appropriations process.

[7]Office of Federal Housing Enterprise Oversight, *Systemic Risk: Fannie Mae, Freddie Mac, and the Role of OFHEO* (Washington, D.C.; Feb. 4, 2003).

Housing GSE Regulatory Reform Is Necessary to Better Ensure Safety and Soundness and Mission Achievement

We continue to believe that the current fragmented regulatory structure for the housing GSEs is inadequate to monitor these large and complex financial institutions and their mission activities. Establishing a single housing GSE regulator that is equipped with adequate authorities and governed by a board would better ensure that the GSEs operate in a safe and sound manner and fulfill their housing missions.

Current GSE Regulatory Structure Is Fragmented, OFHEO Lacks Key Authorities, and HUD's Mission Oversight Capacity Is Questionable

The current fragmented structure of federal housing GSE regulation does not provide for a comprehensive and effective approach to safety and soundness regulation. Although the housing GSEs operate differently, they share common characteristics as large and complex financial institutions. For example, the GSEs rely on sophisticated strategies and activities, such as the use of derivatives, to manage the interest rate and other risks that are inherent in their operations. In recent years, the GSEs, as discussed earlier, have not always demonstrated the capacity to effectively manage the risks that they face.

Moreover, OFHEO, and FHFB to a lesser degree, lack key authorities to fulfill their safety and soundness responsibilities, as described below:

- Unlike bank regulators and FHFB, (1) OFHEO's authority to issue cease and desist orders does not specifically list an unsafe and unsound practice as grounds for issuance and (2) OFHEO's powers do not include the same direct removal and prohibition authorities applicable to officers and directors.
- Bank regulators have prompt corrective action authorities that are arguably more robust and proactive than those of OFHEO and FHFB. These authorities require that bank regulators take specific supervisory actions when bank capital levels fall to specific levels or provide the regulators with the option of taking other actions when other specified unsafe and unsound actions occur.[8] Although OFHEO has statutory authority to take certain actions when Fannie Mae or Freddie Mac capital falls to predetermined levels, the authorities are not as proactive or broad

[8]Capital can be a lagging indicator of unsafe and unsound conditions at financial institutions. Declining asset quality is an unsafe and unsound condition that may be identified months or years before capital declines.

as those of the bank regulators.[9] OFHEO also has established regulations requiring specified supervisory actions when unsafe conditions are identified that are not related to capital adequacy, but OFHEO's statute does not specifically mention these authorities. FHFB's statute does not establish a prompt corrective action scheme that requires specified actions when unsafe conditions are identified. Although FHFB officials believe they have all the authority necessary to carry out their safety and soundness responsibilities, the agency has significant discretion in resolving troubled FHLBanks. Consequently, there is limited assurance that FHFB would act decisively to correct identified problems.

- Unlike bank regulators—which can place insolvent banks into receivership—and FHFB, which can take actions to liquidate an FHLBank, OFHEO is limited to placing Fannie Mae or Freddie Mac into a conservatorship.[10] Thus, it is not clear that OFHEO has sufficient authority to fully resolve a situation in which Fannie Mae or Freddie Mac is unable to meet its financial obligations.

In addition to concerns about OFHEO's and FHFB's authorities to fulfill their safety and soundness responsibilities, the fragmentation of authorities and responsibilities between OFHEO and HUD amplify our significant concerns with HUD's capacity as the mission regulator for Fannie Mae and Freddie Mac. The ability for a regulator to assess tradeoffs that may be present between mission achievement and financial soundness, especially in the presence of the housing market turmoil we are currently experiencing, is especially important. As stated in our previous testimony, HUD officials we contacted said the department lacked sufficient staff and resources necessary to carry out its GSE mission oversight responsibilities. According to HUD's Director of Government-Sponsored Enterprise Oversight, HUD currently has a total of about 17 full time positions that are dedicated to GSE mission oversight. While HUD's ability to ensure adequate resources for its GSE oversight

[9]For example, bank regulators generally are required to take specified regulatory actions at earlier stages of capital depletion than is OFHEO. Bank regulators also are required to initiate four supervisory actions against an undercapitalized institution—including restricting asset growth—while OFHEO is mandated to take only two actions (not including restricting asset growth).

[10]According to OFHEO officials, a receivership is empowered to take over the assets and operate an entity, assuming all of its powers and conducting all of its business as well as removing officers and directors. A receiver may place the failed institution into liquidation and sell its assets. While a conservator may also remove officers and directors of an entity, a conservator is typically appointed to conserve rather than dispose of assets.

responsibilities is limited, its mission oversight responsibilities are increasingly complex. For example, as we have noted in the past, it is not clear that HUD has the expertise necessary to review sophisticated financial products and issues, which may be associated with the department's program review and approval and general regulatory authorities.[11] In addition, without the authority to impose assessments on Fannie Mae and Freddie Mac to cover the costs associated with their mission oversight, it would appear that HUD will always be challenged to fulfill its GSE mission oversight responsibilities.

A Single Housing GSE Regulator Equipped with Sufficient Authorities and Governed by a Board or Hybrid Board Structure Is Critical

To address the deficiencies in the current GSE regulatory structure that I have just described, we have consistently supported and continue to believe in the need for the creation of a single regulator to oversee both safety and soundness and mission of the housing GSEs.[12] A single regulator could be more independent, objective, efficient, and effective than separate regulatory bodies and could be more prominent than either one alone. We believe that valuable synergies could be achieved and expertise in evaluating GSE risk management could be shared more easily within one agency. In addition, we believe that a single regulator would be better positioned to oversee the GSEs' compliance with mission activities, such as special housing goals and any new programs or initiatives the GSEs might undertake. This single regulator should be better able to assess the competitive effects of these activities on all three housing GSEs and better able to ensure consistency of regulation for GSEs that operate in similar markets.

Further, a single regulator would be better positioned to consider potential tradeoffs between mission requirements and safety and soundness considerations, because such a regulator would develop a fuller understanding of the operations of these large and complex financial institutions. Some critics of combining safety and soundness and mission have voiced concerns that doing so could create regulatory conflict for the regulator. However, we believe that a healthy tension would be created

[11]See GAO, *Government Sponsored Enterprises: Federal Oversight Needed for Nonmortgage Investments*, GAO/GGD-98-48 (Washington, D.C.: Mar. 11, 1998). HUD's general regulatory authority can be used to limit or disallow activities that are determined not to support the mission of Fannie Mae or Freddie Mac.

[12]See GAO, *Government-Sponsored Enterprises: Advantages and Disadvantages of Creating a Single Housing GSE Regulator*, GAO/GGD-97-139 (Washington, D.C.: July 9, 1997).

that could lead to improved oversight. The tradeoffs between safety and soundness and compliance with mission requirements could be best understood and accounted for by having a single regulator that has complete knowledge of the financial conditions of GSEs, regulates the mission goals Congress sets, and assesses efforts to fulfill them.

Adequate Regulatory Authorities Are Essential

It is essential that the new GSE regulator have adequate powers and authorities to address unsafe and unsound practices, respond to financial emergencies, and ensure that the GSEs comply with their public missions. These authorities include (1) cease and desist authority related to unsound practices, (2) removal and prohibition authority related to officers and directors, (3) prompt corrective action authority for inadequate capital levels as well as other unsafe and unsound conditions, and (4) authority to resolve a critically undercapitalized GSE, which may include placing it into receivership. Additionally, the new housing GSE regulator should have the authority to adjust as necessary the housing enterprises' minimum and risk-based capital requirements to help ensure their continued safety and soundness.

We also believe that the new GSE regulator should be tasked with the responsibility of conducting research on the extent to which the housing GSEs are fulfilling their housing and community development missions. There are already questions about the extent to which the housing GSEs' retained mortgage holdings benefit housing finance markets. Moreover, studies by federal agencies, academics, and the GSEs have estimated the extent to which Fannie Mae's and Freddie Mac's activities generate savings to home buyers and have reached differing conclusions. Additional studies may be needed to more precisely estimate the extent to which the GSEs' activities benefit home buyers. Further, there is limited empirical information on the extent to which FHLBank advances lower mortgage costs for home buyers or encourage lenders to expand their commitment to housing finance. Without better information, Congress and the public cannot judge the effectiveness of the GSEs in meeting their missions or whether the benefits provided by the GSEs' various activities are in the public interest and outweigh their financial and systemic risks.

New GSE Regulator Should Have a Board or Hybrid Board/Director Governance Structure

In determining the appropriate structure for a new GSE regulator, I note that Congress has authorized two different structures for governing financial regulatory agencies: a single director and board. Among financial regulators, single directors head the Office of the Comptroller of the Currency, the Office of Thrift Supervision and OFHEO, while boards or commissions run FHFB, the Securities and Exchange Commission, and the Board of Governors of the Federal Reserve System, among others. The single director model has advantages over a board or commission; for example, the director can make decisions without the potential hindrance of having to consult with or obtain the approval of other board members.

However, in our previous work, we have stated that a "stand-alone" agency with a board of directors would better ensure the independence and prominence of the regulator and allow it to act independently of the influence of the housing GSEs, which are large and politically influential. A governing board may offer the advantage of allowing different perspectives, providing stability, and bringing prestige to the regulator. Moreover, including the Secretaries of Treasury and HUD or their designees on the board would help ensure that GSE safety and soundness and housing mission compliance issues are both considered.

I would note that in other regulatory sectors—besides financial regulation—Congress has established alternative board structures that could be considered as potential models for the new GSE regulator. One such alternative structure would be the hybrid board/director governance model. Under such an approach, a Presidentially appointed and Senate-confirmed agency head could report to a board of directors consisting of secretaries from key executive branch agencies, such as Treasury and HUD. Having board members from the same political party could lessen some of the tensions and conflicts observed at boards purposefully structured to have a split in membership along party lines. However, a board composed of members from the same political party may not benefit from different perspectives to the same extent as a board with members from different political parties. Therefore, an advisory committee to the regulator could be formed to include representatives of financial markets, housing, and the general public. This advisory committee could be required to have some reasonable representation from different political parties.

Regulatory Funding Structure

Finally, I would like to comment on issues surrounding the potential funding arrangements for a new housing GSE regulator. Exempting the new GSE regulator from the appropriations process would provide the agency with the financial independence necessary to carry out its responsibilities. More importantly, without the timing constraints of the appropriations process, the regulator could more quickly respond to budgetary needs created by any crisis at the GSEs. However, being outside the appropriations process can create tradeoffs. First, while the regulator will have more control over its own budget and funding level, it could lose the checks and balances provided by the federal budget and appropriations processes or the potential reliance on increased appropriations during revenue shortfalls. As a result, the regulator may need to establish a system of budgetary controls to ensure fiscal restraint.

Second, removing the regulator from the appropriations process could diminish congressional oversight of the agency's operations. This tradeoff could be mitigated through increased oversight by the regulator's congressional authorizing committees, such as a process of regular congressional hearings on the new GSE regulator's operations and activities.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions that you or other Members of the Committee may have.

GAO Contacts and Staff Acknowledgments

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HEARING BEFORE THE

U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

ENTITLED

REFORMING THE REGULATION OF THE GOVERNMENT SPONSORED ENTERPRISES

WRITTEN TESTIMONY OF VINCENT E. MALTA

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MARCH 6, 2008

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EQUAL HOUSING OPPORTUNITY

Chairman Dodd, Senator Shelby and Members of the Committee, thank you for inviting me to testify today on the important issue of reforming the regulation of the government-sponsored enterprises (GSEs). My name is Vince Malta. I am the owner and broker of Malta & Co., Inc., a San Francisco, California firm handling real property sales and management of over 300 residential rental units. I am a member of the California Association of REALTORS® and National Association of REALTORS® and have held a number of leadership positions in both associations, including serving as the 2006 President of the California Association of REALTORS® and the 2008 Chair of the Public Policy Coordinating Committee for the National Association of REALTORS®. I also serve on Fannie Mae's National Housing Advisory Council which is comprised of mortgage bank officials, financial services companies, homebuilders, real estate professionals, leaders of affordable housing groups, and governmental officials. My tenure on the National Housing Advisory Council is voluntary and I am not compensated for my service.[1]

I am here to testify on behalf of our more than 1.3 million REALTOR® members who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®. We commend the committee for holding today's hearing on the enhancing the GSEs regulatory system. Fannie Mae and Freddie Mac are partners in the housing industry. As such, we believe today's hearing is an important step towards consideration of

[1] The National Housing Advisory Council was created by Fannie Mae in 1971. It meets with Fannie Mae's senior management team throughout the year to help the company better address challenges and maximize market opportunities. Council members serve two-year terms and do not receive compensation for their service. Members are, however, reimbursed for travel related expenses when attending Council meetings.

legislative proposals designed to strengthen the regulation of the housing GSEs and the Federal Home Loan Banks.

NAR actively supported H.R. 1427, the "Federal Housing Finance Reform Act of 2007," introduced by Chairman Barney Frank (D-MA) together with Representatives Richard Baker (R-LA), Mel Watt (D-NC) and Gary Miller (R-CA). That bill overwhelmingly passed the House of Representatives on May 29, 2007, by a bipartisan vote of 313 to 104. We are eager for the Senate Banking Committee to pursue similar GSE reform legislation and ask you to consider the following elements, which we believe are important considerations in any effort to improve the regulation of the housing GSEs. They are:

1. Strong regulator and GSE governance;
2. Conforming loan limits;
3. Housing mission;
4. New program approval;
5. Separation of mortgage origination and the secondary market ("bright line"); and
6. Portfolio limits.

Strong Regulator and GSE Governance

Over the last two years, general agreement has evolved on a basic framework for a new GSE regulatory structure. That consensus strongly suggests that the current regulatory responsibilities of the Office of Federal Housing Enterprise Oversight (OFHEO), the Department of Housing and Urban Development (HUD), and the Federal Housing Finance Board should be transferred to a single, independent safety and soundness regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. This new housing enterprises regulator should have the authority to set capital standards; liquidate a financially unstable enterprise through a conservator or receiver; and approve new programs and products. The Federal Home Loan Banks should be regulated under the same framework, with due concern for its cooperative ownership by member financial institutions.

NAR supports legislation strengthening the financial soundness regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks through the creation of an independent regulatory agency. Having independent, expert financial oversight will only serve to enhance confidence in the nation's housing finance system. This new regulator should have the appropriate authority and resources to oversee safety and soundness of the GSEs. The regulator also should understand and support the GSEs' vital housing finance mission and the role that housing plays in the nation's economy and public policy.

NAR also supports a continued independent, public voice in the corporate governance of the GSEs. We believe that the boards of directors of Fannie Mae, Freddie Mac and the Federal Home Loan Banks should be well balanced, composed of individuals with the knowledge and expertise necessary to oversee the full range of GSE-related issues and activities. NAR supports legislative efforts to address concerns regarding the governance of the Federal Home Loan Banks by enhancing the Banks' direct role in selecting board members, increasing the number of independent directors, adding community and economic development expertise, and allowing appointed independent directors to continue their service until a successor is in place.

Conforming Loan Limits

Under current statute, Fannie Mae and Freddie Mac may only purchase mortgages that are within a cap that is determined based on an annual survey of house prices and applied nationally. While we greatly appreciate the temporary loan limit increase included in Congress' economic stimulus package it is just that – temporary – and will expire on December 31, 2008. NAR has concerns as to whether the increase will be in place long enough to ameliorate the difficult housing cycle we are experiencing. Thus, NAR urges the Senate to permanently increase the national conforming loan limit to an amount no less than 50 percent higher than the current conforming loan limit ($625,500 or higher). In addition, NAR asks the Senate to make the temporary conforming loan limit increase for high cost areas as provided in the economic stimulus legislation permanent. Accordingly, for high cost areas, the conforming loan limit would be increased to 125 percent of the local median home sales price, but not to exceed $729,750.

The GSEs were created to provide liquidity to the mortgage market. Over the decades, they have developed a secondary market for conforming loans that has generated a reliable, low-cost supply of mortgage credit in both good times and in bad. The same cannot be said of the secondary market for jumbo mortgages. By the end of 2007, the volume of jumbo loans had dropped sharply to half of the total originations at the beginning the year. The little, if any, investor appetite for securities backed by nonconforming mortgages has resulted in a spike in interest rates for jumbo borrowers to about 1 percentage point higher than conforming loans.

Permanently increasing the national conforming loan limit to $625,500, together with allowances for higher limits in more expensive areas of the country, will significantly bolster homebuyer confidence and will bring families back to the marketplace. Furthermore, the loan limit increases will offer more families more affordable interest rates, regardless of where they live. The result will be new additional sales, which lowers inventories and strengthens home prices.

Many research studies have found that home prices have the biggest impact on foreclosures. Therefore, any strengthening of home prices could have the biggest impact in reducing the number of foreclosures. The micro-level solution of loan modifications for financially stressed homeowners and the FHA Secure program will no doubt help lessen the foreclosure problems. However, a broad stroke that would lift housing demand will do more to restore the housing market and the economy to their normal healthy conditions.

The critical role that the GSEs play in providing liquidity to the mortgage market has never been more evident than it is today. Based on 2006 Home Mortgage Disclosure Act (HMDA) data, jumbo mortgages represented almost one million single-family, first lien mortgages originated in almost every state. While jumbo mortgages may be associated with luxury housing in some parts of the country, they are a critical financing vehicle for large numbers of working class families who happen to live and work in more expensive areas of the country. Raising the GSEs' conforming loan limits will provide much-needed relief to jumbo borrowers and homebuyers by increasing access to safer mortgages, which is especially important for first-time homebuyers and borrowers with abusive subprime mortgages who need to refinance. Evidence indicates that borrowers in expensive markets such as California currently account for a disproportionate share of subprime mortgages. Greater access to GSE-qualifying mortgages will help promote homeownership in a safer, more sustainable way.

NAR estimates that increasing the national GSE loan limit to $625,500 and establishing high cost area limits of 125 percent of the local median home sales price, not to exceed $729,750, will result in:

- More than 348,000 additional home sales;
- Over $44 billion in increased economic activity;
- $274 to $411 savings per month in interest payments for consumers who get new "conforming jumbo" loans versus current private jumbo loans;
- More than 500,000 loans above $417,000 refinanced to lower interest rates;
- A reduction of the national supply of homes on the market by 1 to 1 1/2 months;
- A strengthening of home prices by 2 to 3 percentage; and
- A reduction of foreclosures by 140,000 to 210,000.

Finally, we note that there is precedent for regional adjustments for high cost areas. In 1980, Congress designated Alaska, Hawaii, Guam, and the U.S. Virgin Islands as high cost areas. The conforming loan limit in these statutory high cost areas is 50 percent higher than for the rest of the nation, but housing prices in these areas are no longer uniquely high. In fact, housing prices in many areas of the country now exceed those in Honolulu. NAR urges the Senate to include in any GSE reform bill a permanent increase of the national conforming loan limit to no less than 50 percent higher than the current conforming loan limit (to $625,500 or higher) and to make permanent the temporary conforming loan limit increase for high cost areas, as provided in the economic stimulus legislation.

Housing Mission and the Secondary Mortgage Market

Congress chartered Fannie Mae and Freddie Mac with advantages unavailable to commercial banks and other financial institutions. Fannie Mae and Freddie Mac enjoy lower funding costs, the ability to operate with less capital, and lower direct costs. These advantages were and are an integral component of the GSEs' public policy mission. The advantages of GSE status have helped the secondary mortgage market grow and provided much needed stability to our nation's housing financial system.

Very simply, Congress created Fannie Mae and Freddie Mac to do what no fully private company could or was willing to attempt. Unlike private secondary market investors, Fannie Mae and Freddie Mac remain in housing markets during downturns, using their federal ties to fulfill their public purpose obligation to facilitate mortgage finance and support homeownership opportunity.

In their own ways, each of the housing enterprises has used their federal charter advantages to meet their missions. The "mechanism that widens the circle of ownership," as one observer defined the secondary mortgage market, is dynamic, robust and continually evolving – all to the benefit of mortgage originators, homebuyers, and other industry participants.

The broad expansion of homeownership, mortgage markets, as well as the related rapid growth of the GSEs has also had another effect. Until the recent credit crunch, financial services providers, many of which compete with Fannie Mae and Freddie Mac, questioned the GSEs' activities, function, and the continuing need for their government-chartered status. These financial companies argued that Fannie Mae and Freddie Mac had an unfair advantage because of their federal charters. Yet these same lenders' parent banking companies have their own federal subsidies that come in the form of deposit insurance and other benefits derived from the nation's banking and financial system safety net.

REALTORS® believe that the GSEs' housing mission, and the benefits that derive from it, play a vital role in the continued success of our nation's housing system. Fannie Mae and Freddie Mac have demonstrated their commitment to housing by staying true to their mission during the current market disruptions. We have opposed and will continue to oppose legislative proposals that would reach beyond safety and soundness regulation and diminish the housing mission and role of the GSEs.

New Program Approval

Currently, Fannie Mae and Freddie Mac cannot initiate a new program without first obtaining the approval of HUD. While NAR has not objected to the new program approval approach in H.R. 1427, we believe that some improvements could be made in a Senate bill to give the GSEs more flexibility to respond effectively to changing mark conditions. NAR would be concerned if Congress enacted legislation that included additional regulatory requirements which could unduly delay or prevent the GSEs from developing new programs and products that support their missions.

For example, such authority should not undermine secondary market innovations based on Fannie Mae and Freddie Mac credit risk management technologies. These innovations assure a smooth supply of reasonably priced mortgage credit and allow homebuyers to manage their interest rate risk when locking loans rates and terms before closing.

NAR believes that whatever approach Congress takes to address the shortcomings of the current statutory framework, the result must be flexible to promote product and program innovation and allow for prompt responses to housing market needs.

Separation of Mortgage Origination and Secondary Market

REALTORS® recognize and support the role that program, business and activity approval may have on the financial safety and soundness of the GSEs. However, not every new activity of the GSEs should be subject to an extended regulatory public comment process. This requirement could directly damage the GSEs' housing mission, and stifle innovation and programs that would help Americans achieve the dream of homeownership.

In the 109th Congress, one legislative proposal that NAR cautioned against was the "bright line" regulation, which would have distinguished mortgage origination from GSE secondary market activities and imposed restrictions on Fannie Mae and Freddie Mac mission-related activities. One "bright line" proposal would have specifically prevented the GSEs from directly or indirectly participating in mortgage origination and may have required Fannie Mae and Freddie Mac to divest themselves of their automated underwriting systems, upon which many banks rely.

REALTORS® oppose overly restrictive "bright line" legislative proposals that explicitly limit GSEs business to the secondary markets, strictly defined. Such a test would instantaneously preclude many of the GSEs' existing products and activities that were designed to increase access to mortgage credit, lower the costs of homeownership, and foster innovations in home financing.

For example, the "bright line" provision would seriously hinder (and possible prohibit) the array of mission-related, consumer outreach activities by lenders and housing counselors that are supported by the GSEs. The GSE-designed counseling and education programs that help lenders, mortgage brokers, REALTORS®, and housing counseling agencies determine a consumer's financial readiness for homeownership are technically on the "wrong side" of the "bright line" and would be prohibited.

This is just one example of the negative impact such a standard would have on critical components of the housing market. REALTORS® urge you to reject the rigidity and arbitrary nature of a statutory "bright line" test.

Portfolio Limits

One of the most widely debated GSE reform issues has been the size of the portfolios currently held by the GSEs and whether these portfolios contribute to the GSEs' mission. Then Federal Reserve Board Chairman Alan Greenspan was one of the most vocal advocates of legislative proposals to shrink the size of the GSEs' retained portfolios. Chairman Greenspan and others have argued that the size of the portfolios, together with the perceived incentives for the GSEs to pursue portfolio growth, increase the possibility of GSE insolvency and destabilization of our nation's financial markets.

Significantly, those advocating retained portfolio limitations do not identify any systemic financial risk. Viewed strictly from a systemic risk perspective, GSE retained portfolios, just like the portfolios of the 5 largest banks in the U.S., are vulnerable to interest rate changes and could pose a risk to taxpayers should the enterprise or the bank become insolvent or improperly hedge risk. We do not see a need to impose additional regulatory authority that goes beyond that of bank regulators. REALTORS® believe that GSE reform legislation should clearly indicate that any portfolio standard must be based solely on safety and soundness of the enterprises, and not on any broader concern such as systemic risk.

REALTORS® also oppose rigid statutory limits on the GSEs' portfolio size. Instead, we believe a better legislative approach would be to create a sufficiently strong regulatory authority over capital that would limit portfolio risk and may also moderate portfolio growth, when appropriate.

While it is obviously important to consider the safety and soundness implications of GSE portfolio size and the associated risks, we would ask that the Congress not ignore the advantages that portfolio holdings and size have on mission-related activities and housing markets. The GSEs point out that the returns earned on retained portfolios help support the enterprises' affordable housing programs and also contribute to the availability of financing for low-income borrowers. For example, in testimony before the House Financial Services Committee last spring, Freddie Mac indicated that about two-thirds of its retained portfolio supported affordable housing and first-time homebuyers.

Simply stated, REALTORS® oppose portfolio limits imposed just for the sake of shrinking the GSE mission. Portfolio limits should not be prescribed in statute. Instead, we believe the portfolios should be regulated by the GSEs from a risk perspective, and the regulator should determine if one or both of the GSEs' retained portfolios affect safety and soundness.

Conclusion

The National Association of REALTORS® shares the belief of our industry partners that Fannie Mae, Freddie Mac and the Federal Home Loan Bank System are integral components of this nation's highly successful housing finance system. Homebuyers depend on the secondary mortgage market to supply a continued and stable source of funding for single-family and multifamily housing.

NAR believes legislation to reform the housing GSEs should be principally focused on safety and soundness regulation and expanding the role of Fannie Mae and Freddie Mac to provide liquidity to the secondary market based on permanent higher conforming loan limits. We hope that Congress can reach a consensus on GSE reform, so that all in the housing industry can focus our efforts on the full range of challenges that lie ahead. The National Association of REALTORS® pledges to work with the Senate to enact GSE reform legislation that achieves our mutual goals and protects the vibrancy, liquidity and evolution of the housing finance system.

NAR Analysis of Housing Market
January 17, 2008

Current Housing Market Conditions - Very Weak

- ***Existing home sales*** have been at roughly 5 million for the past three months, possibly hinting at stabilization and the formation of a bottom. But the current sales pace would only match the 1998 figures (10 years ago) and are down 20% from a year ago and 30% from the cyclical peak in 2005.

- ***New home construction and new home sales*** have contracted even more with the recent new single-family housing starts registering from 800,000 to 900,000 and new home sales falling well below 700,000. Those figures are down by roughly 50% from their respective peak annual figures in 2005.

- ***Home prices*** continue to move lower at the national level. The most timely and broadest measure from NAR based on multiple listing service information indicates a 3% to 6% decline compared a year ago. If sustained in 2008, such a price decline would correspond to a housing equity loss of $700 billion to $1.4 trillion for American homeowners. Correspondingly, consumer spending is expected to contract by $150 billion - easily knocking off 1% point off GDP growth.

- ***The near-term forecast*** continues to point to weak conditions. Housing permits continue to fall - indicating further declines in new home construction and new home sales. NAR's pending home sales index also remains weak.

Pent-Up Housing Demand - Sizable

- ***Job gains and income gains*** have been solid over the past two years – this corresponds with the time period when home sales were falling. Net job gains increased by 4.3 million according to both company payroll data and household survey data. U.S. aggregate personal income rose by $1.4 trillion over the past two years. Such job gains should have translated into about 2 million additional homeowners, yet the actual rise over this two-year span was only 600,000. Over the same time period, housing affordability improved due to incomes rising, home prices falling, and *conforming* mortgage rates at near historic lows, yet … there was a very slow number of net new homeowners.

- ***Household formation*** has mysteriously slowed. With the normal population and job increases, household formation typically expands by 1.2 million to 1.5 million per year. The latest Census data points to only 650,000 net new households formed in 2007. Many people have evidently doubled-up with additional roommates or have moved back with their parents or family members.

Buyer Hesitancy - Why?

- ***Anticipation of lower home prices*** is holding back many people from buying a home today. Foreclosures will continue to rise in 2008. There are many research reports (irrespective of validity) pointing to further price declines.

- ***Anticipation of lower interest rates*** is holding back many potential buyers. It is widely believed that the Federal Reserve will cut rates in the next two meetings. Though there is no direct relationship between a Fed rate cut and mortgage rate changes, many consumers perceive that mortgage rates will fall with the later Fed rate cut. NAR advocates a one-time large rate cut rather than a series of small rate cuts in order to end the delay in home buying.

- ***Subprime lending has virtually disappeared*** since August, 2007. It had comprised about 20% of mortgage originations. Some aspects of subprime lending will return with improved underwriting standards, stricter and sounder regulatory environment, and the proper pricing of risk. But the timing of this return remains very uncertain. A recent pick up in FHA loan endorsement is very encouraging as it brings some would-be subprime borrowers into a loan with much safer interest rates and it helps some homeowners refinance out of their riskier subprime loans.

- ***The Jumbo mortgage market is not functioning***. The current conforming mortgages average is about 6.0%. Based on historical trends, rates on jumbo loans would be about 6.2% or 6.3%. Rather, current jumbo rates are closer to 7.0% due to investor fears of any U.S. mortgage that does not have the (perceived) backing of the U.S. government. Any rational homebuyer will balk at such a higher interest rate.

Summary Table

There are more people with the capacity to buy a home at lower prices and improved affordability, yet home sales have been drastically reduced.

	2005 Peak Housing Year	*2007*	*Difference*
Pent-Up Demand			
Jobs (payroll survey)	133.7 million	138.0 million	+ 4.3 million
Personal Income)	$10.3 trillion	$11.7 trillion	+ $1.4 trillion
Household Net Worth	$52.1 trillion	$58.6trillion	+ $6.5 trillion
Home Buying Condition			
Home price (median)	$219,600	$217,600	- $2,000
Mortgage Rate	5.9%	6.3%	+ 0.4% points
Affordability Index	113	114	+ 1
Housing Activity			
Total home sales	8.4 million	6.4 million	- 2 million

MORTGAGE BANKERS ASSOCIATION
Investing in communities

Testimony of Kieran P. Quinn, CMB, Chairman

Mortgage Bankers Association

Washington, D.C.

before the

Committee on Banking, Housing and Urban Affairs

United States Senate

Hearing on

"Reforming the Regulation of Government Sponsored Enterprises"

March 6, 2008

Chairman Dodd, Ranking Member Shelby and Members of the Committee, my name is Kieran P. Quinn, and I am Chairman of the Mortgage Bankers Association.[1] I am also Chairman of Column Financial, Credit Suisse's mortgage lending subsidiary for multifamily, hotel, retail and commercial properties. Thank you for the opportunity to testify before you today as you refocus the Committee on developing legislation to reform the nation's regulation of the Government Sponsored Enterprises (GSEs), including Fannie Mae and Freddie Mac as well as the Federal Home Loan Banks.

I have been in the mortgage lending business for 30 years and my company has transacted business with both the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) on a regular basis. In my official capacity at MBA, I have worked with representatives of lenders of all business models and sizes from across the nation to develop MBA's policies on GSE oversight reform.

Before I begin, please let me say Mr. Chairman MBA particularly appreciates Congress' rapid and bipartisan response to the difficult conditions in the national economy. MBA believes the housing components of the Economic Stimulus Act of 2008, signed by the President on February 13, (P.L. 110-185) will bring much needed liquidity for the mortgage markets, particularly in areas with high housing costs. MBA also appreciates the dedication of the Committee to GSE oversight reform. This legislation is a first priority of MBA and the mortgage industry and MBA will do all it can to assist your work.

I. INTRODUCTION AND SUMMARY

The most recent opportunity the MBA has had to offer testimony on GSE regulatory reform occurred in March 2007 during a House hearing on the subject. It is astonishing to consider the scope and magnitude of events that have transpired within the housing finance system since that time. One sector after another became debilitated by a market-shaking crisis, until the entire system ground to a near standstill as creditors began losing confidence in the portfolios of their lending partners. I describe it as a "near standstill" because at one point, there were only four entities engaging in secondary market transactions – Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, and Ginnie Mae. It is no exaggeration to say that as bleak as things have become, just imagine how much worse conditions in the housing finance system would be without the GSEs. It is just this type of calamity Congress sought to avoid when the

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

GSEs were chartered. And so, now as always, MBA strongly supports the vital role Fannie Mae and Freddie Mac play in maintaining and improving liquidity and stability in the secondary mortgage market. MBA also strongly supports the vital role that the Federal Home Loan Bank System plays in providing liquidity to the primary mortgage market and supporting the demand for mortgages through advances by the FHLBanks to their members.

Although all of these enterprises are government sponsored, for the remainder of my remarks today, I will use the term GSEs when referring to Fannie Mae and Freddie Mac and, when I refer to the Federal Home Loan Bank System, I will use the term FHLB System or FHLBanks.

GSE and FHLBank System reform legislation has been on the congressional agenda since 2003. Since that time, accounting irregularities, charter infractions, corporate governance misdeeds and market fluctuations have shed light on the fact the strength of the GSE supervisory framework has not kept pace with the size and complexity of the entities under supervision or the market in which they operate. Even though current conditions seem bleak, there will come a day when non-GSE sources of liquidity will return to the secondary market. When this happens, the primary market will become vibrant and once again blossom with innovations in housing finance products and services. To hasten this return to normalcy, MBA implores Congress to fortify the GSE and FHLBank supervisory framework in a comprehensive manner to ensure that these entities focus on their housing finance mission within their duly authorized charter purposes and secondary market powers.

The recent turmoil in the housing finance system has demonstrated the need for enhanced accountability for all participants. Lending institutions and other primary market participants must ensure that they are compliant with all consumer disclosure and safety and soundness requirements. Investors and other secondary market participants must adopt risk management practices commensurate with the level of sophistication of the transactions in which they engage. Consumers must heighten their accountability to ensure they have adequate resources to satisfy their long term financial obligations. Finally, regulators must be proactive, communicate with each other, and establish clear parameters so that authorized activities can be conducted in a safe and sound manner.

MBA offers the following suggestions for addressing this last concern as it relates to statutory reform of the structure and powers of the GSEs' and FHLBanks' supervisor:

1. The GSEs and the FHLBanks should be supervised by a single, independent regulator with the duty to ensure their mission compliance and safety and soundness. The fundamental differences between the GSEs and the FHLBanks should be reflected in the supervisory structure.

2. A statutory framework should be established to empower the GSE regulator with the full range of safety and soundness oversight authority possessed by similar

federal financial institution regulators. It should also detail the regulator's powers with respect to mission compliance.

3. The statute should include thresholds for the GSEs' and FHLBanks' authorized activities and safety and soundness requirements. These thresholds should not hinder the regulator's authority to revise these requirements as markets demand or in exigent circumstances.

4. The statute should also establish affordable housing goals that are reasonable and do not distort the market but nonetheless, require the GSEs to lead the market in encouraging lending in underserved markets and to underserved families.

The remainder of my remarks discusses each of these principles and provides suggestions for incorporating them into GSE regulatory reform legislation. MBA appreciates the recent efforts of HUD and OFHEO to respond to disruptions in the secondary market. Given the current market conditions in the housing finance system, MBA believes it is imperative that we provide sufficient powers to enable the GSEs' regulator to respond to future, unforeseen calamities.

III. SAFETY AND SOUNDNESS OVERSIGHT OF THE GSEs BENEFITS THE ENTIRE MORTGAGE MARKET

The GSEs must act in a safe and sound manner to perform their secondary market functions, including meeting specific affordable housing goals. Our housing finance system, made up of both GSEs and private companies, requires access to liquid funds day in and day out from both American and international capital sources. The housing GSEs are major links between the capital market and the housing market.

Furthermore, regulating the safety and soundness of two firms as big and as complex as Fannie Mae and Freddie Mac is extremely challenging. Under trying circumstances, OFHEO has done an admirable job of using the supervisory tools at hand to discharge its duties. For example, we note OFHEO's recent decision to lift the cap on each of the GSE's mortgage portfolio while preserving their higher capital requirements for the time being. Nevertheless, OFHEO's strongest supervisory actions to date were effectuated through consent orders negotiated with each GSE. Fannie Mae and Freddie Mac inevitably will remediate the operational and control weaknesses that triggered their respective consent orders. When this happens, it may become more difficult for OFHEO to successfully take such an aggressive approach to supervision as a consent order. To avoid this possibility we believe the GSE regulator should be equipped with a specific range of powers and protocols commensurate to the severity of the situation.

Unquestionably, MBA remains firm in its support for efforts to expressly confer powers and procedural parameters on the regulator, on par with modem U.S. bank regulators, to carry out every aspect of sound regulation. For example, the regulator needs general regulatory authority, which OFHEO currently lacks. As mentioned above, cease and desist authority is another fundamental, effective, flexible, and important tool a financial regulator can have. Regulators can narrowly tailor cease and desist orders to resolve a particular problem, without otherwise limiting or interfering with the institution's operations. Assuring flexibility in cease and desist orders makes them effective.

We believe that the entire secondary mortgage market would benefit from this enhanced clarity regarding the range of possible supervisory actions the GSEs' regulator could take in response to various supervisory concerns.

A. Capital Regulation

It is important that Fannie Mae and Freddie Mac maintain capital levels that support liquidity for the residential mortgage markets and that are also consistent with safety and soundness, stability for the overall market, and minimum exposure to risk for the American taxpayer. Some have proposed that the regulator's capital setting authority should permit the regulator to require capital increases only in a narrow set of circumstances. MBA does not share that approach. MBA believes the regulator should have flexible authority to set appropriate capital standards.

Today, Freddie Mac's and Fannie Mae's capital surcharge is based on OFHEO's cease and desist authority, not its capital authority. OFHEO's cease and desist authority is flexible and can address many problems, not just capital deficiencies. If, under new law, the regulator's capital authority is limited, it is possible that some might infer that the regulator's cease and desist authority has also been limited. In order to preserve its usefulness as a flexible and powerful supervisory tool, it is important that Congress be careful not to inadvertently limit the regulator's cease and desist authority.

B. Receivership

Congress has debated whether to include provisions that would permit a regulator to appoint a receiver if either Fannie Mae or Freddie Mac were to become financially distressed. MBA's view is that in the unlikely event of distress at either company, it is important to maintain the operations of mortgage finance markets. MBA believes this should be the fundamental principle behind any receivership provisions.

MBA does not believe the regulator should appoint a receiver or conservator lightly. Rather, the regulator should only be able to appoint a conservator or receiver when there is a serious capital deficiency, a serious threat to liquidity, or a real possibility of market disruption.

When a regulator does need to intervene, it should be able to operate the enterprise to restore it to health if that would best protect the housing markets. If necessary, the regulator should be able to maintain the operations of the mortgage securitization business, which is critical to the markets, while winding down the portfolio operation in an orderly manner. Because it may be necessary for a GSE in receivership to issue debt to ensure an orderly wind-down of the portfolio business, the receiver should of course have the authority to cause the GSE to issue debt to ensure that orderliness.

To ensure certainty in the markets today, before there is a problem, Congress also should specify a priority of claims in the event either Fannie Mae or Freddie Mac is in receivership. Congress should specify that holders of MBS that the GSE had issued have a prior claim to the mortgages backing the MBS, as well as to the flow of revenue the GSE continues to receive as guarantee fees. That guarantee fee revenue would be necessary for the securitization business to continue. The securitization business is critical to the market's functions, and Congress should ensure its continuation even if Fannie Mae or Freddie Mac is in receivership. These provisions would help maintain the operations of the mortgage finance markets, which should be the underlying policy for any Congressional action in this area.

Only Congress, not the regulator, should be able to rescind a GSE's charter.

C. Portfolio Restrictions

During discussions of regulatory improvements, it has been suggested that Congress should place strict limits on the size of Fannie Mae's and Freddie Mac's portfolios of mortgage loans and MBS due to risks arising from these portfolios. Fannie Mae and Freddie Mac have been subject to portfolio caps as a result of their respective consent order agreements with OFHEO. These caps were lifted by OFHEO as of March 1. Since the beginning of the mortgage market disruptions, many industry participants, including MBA, appealed to Congress and OFHEO to rescind the caps so that the GSEs could purchase more loans in order to provide greater liquidity to the secondary market. We reiterate our support for OFHEO's decision to lift the cap while preserving the temporarily higher capital requirements. Present circumstances demonstrate all too well that the mortgage and financial markets fluctuate and evolve. Because the GSEs' portfolios can and do provide liquidity and stability in times like these, MBA believes that a congressionally mandated dollar cap or limit on the GSEs' portfolios would impede the GSEs' ability to respond to market conditions.

The portfolios also help the GSEs meet their statutory affordable housing goals. Special loan structures enable many lower income families to purchase homes. And, some of the unique characteristics of single-family reverse mortgages for the elderly make them difficult to securitize. Both Fannie Mae and Freddie Mac purchase a significant number of single-family and multifamily loans that are not easily securitized for their portfolios and these purchases make a critical contribution to the GSEs' ability to meet their goals. A rigid portfolio limitation could interfere with this important source of financing for affordable homes for lower income Americans. Finally, by financing their portfolios, the GSEs also have attracted significant foreign capital to the American mortgage markets, spurring further growth in the U.S. housing market. The GSEs' portfolio functions should be preserved.

MBA does not support the establishment of arbitrary limits on the GSEs' portfolios. Instead, MBA believes the regulator should be authorized to assess the risks in each GSE's portfolio and the degree to which the portfolio supports the GSE's secondary market and affordable housing missions. Based on this analysis, the regulator should be empowered to design appropriate means for limiting the risks of the portfolios considering current financing needs.

D. GSE Exemption from SEC Registration

The GSEs' charters contain specific exemptions from Securities and Exchange Commission (SEC) registration. In response to a considerable degree of pressure, the GSEs agreed in July 2002 to register one class of their common stock under Section 12 (g)[2] of the Securities and Exchange Act of 1934 (the '34 Act or the Exchange Act). Pursuant to the Exchange Act's reporting requirements, the GSEs agreed to file annual, quarterly and current reports updating their financial materials which will be subject to SEC review and comment.

The issue is whether this level of voluntary filing is sufficient, or whether the GSEs' SEC exemption should be eliminated and the GSEs should be required to fully register their debt, equity and MBS issuances. There would appear to be no adverse impact to the housing finance system, or significant additional burden to the GSEs, of requiring Fannie Mae and Freddie Mac to register either their non-MBS debt or their equity securities under the Securities Act of 1933 and the Exchange Act of 1934. However, MBA believes the statutory exemption for MBS issued by the GSEs should be preserved.

GSE MBS is traded through pools with specified characteristics and through trades of MBS of a generic nature, not yet identified. These generic MBS are traded in the to-be-announced, or TBA, market. The TBA market has numerous uses for the mortgage industry, including dollar roll hedging, without the intent to take control of the actual collateral, reference pricing, purchasing collateral for future structured transactions, and other purposes. One problem with SEC registration for GSE MBS is that TBA securities could not comply with the rigorous disclosure regime required under the SEC's Regulation AB because actual information is not available for these issuances prior to purchase.

A second concern is that there would be significant transaction delays caused by the SEC process. According to 2004 testimony by the SEC, the timing of transactions could be affected.[3]

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[2] Under Section 12(g), an issuer that is exempt from the 1934 Act can register its stock with the SEC. Once an issuer submits to the registration and reporting requirements, it can opt to discontinue that status only under very limited circumstances. For practical purposes here, it is a permanent election.

[3] See testimony of Alan Beller, Director, SEC Division of Corporate Finance, before the Committee on Bank, Housing and Urban Affairs, United States Senate, February 10, 2004. www.sec.gov/news/testimony/ts021004alb.htm

A third problem with bringing GSE MBS under SEC registration is that the lenders who sell their mortgages in return for MBS could be viewed under the securities laws as underwriters with underwriter liability. All of these factors will converge to make GSE executions more expensive and impede a market which is working very well.

At the same time, it does not appear that investors would gain much by virtue of registration of GSE MBS. Investors already have distinctive safeguards with GSE MBS for several reasons:

- Fannie Mae and Freddie Mac mortgage securities almost always include a *corporate guarantee* that principal and interest will be paid in the manner described and principal will be repaid;

- Fannie Mae and Freddie Mac remain engaged in their transactions in significant roles, including as trustee, master servicer, and guarantor; and

- Fannie Mae and Freddie Mac are responsible under the terms of their agreements to assume servicing responsibilities in the event of a default and to assure that the loans are serviced as agreed.

IV. MISSION OVERSIGHT

The need to assure that the GSEs carry out their charter purposes and statutory responsibilities and do not stray beyond them is equally important to effective oversight of all secondary market GSEs. Both GSEs receive significant explicit and implicit public advantages intended to facilitate their secondary market functions. These benefits include exemptions from certain state and local taxes, lines of credit with the U.S. Treasury and extraordinary borrowing advantages in the capital markets resulting from their public ties. The FHLBanks also benefit from a variety of statutory advantages.

The new GSE regulator must assure that the GSEs are carrying out their secondary market functions and assisting, but not harming the work of, the primary mortgage market. Although the Department of Housing and Urban Development (HUD) has worked hard at mission regulation of the GSEs, it has had even fewer resources and less direction than OFHEO to carry out its functions.

Prior to the recent market disruptions, the secondary mortgage market enjoyed vigorous competition among thousands of largely private industry firms of all shapes and sizes. Since the credit crunch emerged however, the number of private secondary market participants has dwindled. Currently, the GSEs provide a secondary market and mortgage financing for mortgage lenders for an estimated $4.2 trillion in loans, approximately 70 percent of the total MBS in the nation, and, according to a recent analyst report, an estimated 80 percent of the nation's overall mortgage market. The combined portfolios of the enterprises are estimated to exceed $4 trillion. Their combined outstanding debt is slightly more than that of the United States Treasury. The scale of the Federal Home Loan Bank System lags the total of both of the GSEs but it is massive, too. The total consolidated obligations of the FHLBanks are just under $1 trillion and their member institutions hold over $600 billion in advances from the FHLBanks. Additional statistics regarding primary and secondary market characteristics are included in Appendix A.

As recent conditions demonstrate, properly focusing the GSEs' power, fueled by their public advantages, can assist the primary market in weathering a storm in the housing finance system. If not effectively regulated, the GSEs can wield their market-shaping powers to their own advantage by creating barriers to entry and competition from other primary and secondary market players. Therefore, MBA believes the regulator must have the authority to assure that the GSEs' purposes are performed through new and existing program review authority, general regulatory authority, authority to establish and enforce the housing goals, fair lending and reporting requirements as well as all other mission-related authorities.

A. Affordable Housing Goals

One of the key ways of measuring the mission-related activities of Fannie Mae and Freddie Mac is through their affordable housing goals performance. Congress established these goals by statute in 1992 to clarify the GSEs' obligations to carry out their purposes of serving the primary market by purchasing, in the secondary market, their fair share of mortgage loans made to finance homes including those for low-income families and in underserved areas.

MBA wholly supports the GSEs' requirements to help finance affordable housing. MBA believes the goals should be high enough to cause the GSEs to stretch their reach into underserved markets, but that the goals should be reasonable, to avoid market distortions or other adverse unintended consequences. Congress should not give the regulator authority to set an unlimited number of goals and subgoals.

MBA believes that Congress should retain the existing housing goals, but should amend them to provide greater focus on the housing needs of lower income households. MBA also believes that it is important to focus on what activities count toward the goals and supports, for example, the view that loans that lenders have to repurchase from the GSEs should be subtracted from the goals-eligible loans at the time of the buyback.

B. Goals Credit for GSE Purchases of Senior Tranches of MBS Secured By Subprime ARMs

MBA recognizes that the nonprime mortgage sector has experienced significant loan performance concerns. We commend the federal banking agencies for responding to this issue by reiterating the importance of establishing strong risk management practices and underwriting standards and clear customer disclosures. We understand that the GSEs are working closely with OFHEO to establish risk management procedures relating to purchases of alternative mortgages too. MBA continues to believe that subprime ARMs are useful affordability options for mortgage borrowers including those in the nonprime mortgage market. Therefore, MBA believes that so long as a goals-qualifying mortgage complies with all applicable laws, regulations and regulatory guidance, such mortgages should be eligible for housing goals credit.

Under current law, HUD establishes guidelines to measure the extent of compliance with the goals which may assign full credit, partial credit or no credit toward achievement of the goals to different categories of mortgage purchases.[4] Under a new law, the Director should exercise this authority considering the value of these and other products to homeownership, as well the extent to which purchases of senior tranches of these and other securities add to liquidity and otherwise meet the objectives of the goals.

C. Affordable Housing Fund

Some have suggested that, in addition to retaining the affordable housing goals, Congress should require the GSEs to contribute to a fund to assist lower income families in obtaining affordable housing. While several proposals have been offered on how to calculate the contribution, MBA is supportive of the approach in H.R. 1427 which calculates the contribution as a percentage of outstanding GSE debt. This approach would make it difficult for the GSEs to pass on this cost, thus minimizing the risk that the fund would become a tax on consumers or lenders. It would also tie the contribution to a benefit of government sponsorship, the GSEs' lower capital costs. Notably, the same amount of contribution can be required under this calculation method as any other method.

To assure the funds actually go toward meeting the affordable housing needs for which they are intended, the GSEs' regulator should be responsible for establishing and managing the funds as well as monitoring their administration. MBA believes an advisory board of industry practitioners should be established to assist the regulator in assuring funds are spent appropriately. If the funds are distributed by a formula to state or local agencies to administer, MBA recommends that a process similar to that used for HOME[5] funds be employed so that both cities and states receive an allocation and have the ability to target the funds to areas of greatest need.

D. Expansion of High-Cost Areas and Ceiling Increases for GSE Eligible Loans

The Economic Stimulus Act of 2008 provided a temporary adjustment to the GSE conforming loan limit in areas determined by HUD to be high-cost areas. Prior to enactment of the act, the nationwide conforming loan limit for loans eligible for GSE purchase for securitization or for their portfolios was $417,000 for a single family home.

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[4] Sec. 1336 of FHEFSSA, 12 USC 4566

[5] HOME Investment Partnerships Act, 42 USC 12701 note.

Under the GSEs' charters, this limitation may be increased by up to 50 percent to $625,500 for properties located in Alaska, Hawaii, Guam and the Virgin Islands.

Under the act, the GSEs' loan limits increase to 125 percent of the area median house price for the property up to a statutory cap of 175 percent of the current GSE limit of $417,000 or $729,750 for a single-family property. For areas where 125 percent of the median house price is less than or equal to the GSE limit, the GSE limit is set at, and can go no lower than, the GSE limit of $417,000. For Alaska, Hawaii, Guam and the Virgin Islands the new limits may be increased by 50 percent subject to area median house prices and interpretation of the legislation (up to $1,094,625).

MBA believes the temporary increase in the loan limit for Fannie Mae and Freddie Mac will help consumers by providing important financing options, and will help restart the securitization market for higher value loans. For these reasons, MBA supports a temporary increase in the maximum loan limit that Fannie Mae and Freddie Mac may purchase from lenders, subject to the following conditions:

- The increase should be in effect for no less than 12 months, and up to 24 months if market conditions warrant;
- The temporary cap for a single family property should be set at no more than 150 percent of the current loan limit ($625,500) and should be available nationwide, in every state and U.S. territory; and
- Expanded loan limits should be available for purchase loans and refinancing.

We suggest this Committee consider the above principles if it contemplates any modification or extension of the current temporary limits. In addition, MBA opposes the permanent addition of new high cost states as unwarranted, and we believe the use of ZIP codes, census tracts or a county-based system presents operational difficulties and increased loan costs for both the temporary increases put in place and any permanent changes to the conforming loan limit going forward.

IV. A SINGLE REGULATOR FOR MISSION AND SAFETY AND SOUNDNESS

Another challenge to supervising the GSEs is their unique government sponsored status to achieve a public purpose. The GSEs combine the advantages of government sponsorship with the functional organizations of shareholder-owned corporations. Therefore, the GSEs must be regulated in a manner that ensures they maximize their mission-oriented activities in a fiscally responsible manner. Currently, OFHEO regulates the safety and soundness of Fannie Mae and Freddie Mac and the Department of Housing and Urban Development (HUD) has oversight for their mission-related activities. The Federal Housing Finance Board regulates both the mission and safety and soundness of the FHLBanks. MBA believes the current bifurcation of mission and safety and soundness oversight of the GSEs opens the door to regulatory arbitrage by a GSE or interagency communication missteps. To avoid these situations, the MBA believes a single regulator should be responsible for monitoring the GSEs' activities for mission and safety and soundness purposes.

MBA believes the most compelling reason to have a single mission and safety and soundness regulator is to facilitate evaluations of the GSEs' activities from both a public purpose and fiduciary perspective. Currently, HUD is charged with monitoring the GSEs' adherence to their charters, and OFHEO has oversight for the GSEs' safety and soundness. Like OFHEO, HUD lacks some of the most basic tools to do the job.

The GSEs' charters specify the purposes of the enterprises including: (1) providing stability in the secondary market for residential mortgages; (2) responding appropriately to the private capital market; (3) providing ongoing assistance to the secondary market for mortgages (including activities relating to mortgages on housing for low and moderate income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential financing; and (4) promoting access to mortgage credit throughout the nation including by increasing liquidity and improving the distribution of investment capital available for residential financing.[6]

The charters and current law, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), detail the GSEs' authorities and establish prohibitions against certain activities including the direct origination of mortgage loans.[7] FHEFFSA also establishes the GSE affordable housing goals, fair lending and reporting obligations of the GSEs.

As the GSEs' mission regulator, HUD is empowered to exercise "general regulatory power" to ensure FHEFSSA and the purposes of the GSEs' charters are accomplished.[8] Although HUD's duties include reviewing "new programs" of the GSEs,[9] the specific provisions regarding new program review are constrained by a rigid time frame and unclear statutory review standards. Moreover, HUD is bound by the time frame for review regardless of the program's level of complexity.

The current definition of a "new program" effectively limits the programs subject to review and the standard of review does not allow HUD to reject a program unless it can demonstrate that it is unauthorized under broad authorities or the program is "not in the public interest." Current law also does not allow HUD to reject a program application on safety and soundness grounds. It is not clear to what extent the regulator may review and order a stop to ongoing activities outside of the GSEs' charter. To carry out all

[6] 12 USC 1716, 12 USC 1451 note. The Fannie Mae Charter includes a fifth purpose concerning managing and liquidating federally owned mortgage portfolios in an orderly manner.

[7] Section 304(a)(2)(B) of the Fannie Mae Charter, 12 U.S.C. 1716,; Section 305(a)(5) of the Freddie Mac Charter,12 U.S.C. 1451.

[8] Sec. 1321 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), 12 USC 4541.

[9] Sec.1322 of FHEFSSA, 12 USC 4542.

these functions, HUD's budget has been woefully inadequate. MBA supports legislation to address all of these matters.

V. ASSURING THE GSEs' PERFORMANCE IS CONSISTENT WITH THEIR MISSIONS

Congress chartered Fannie Mae and Freddie Mac and conferred substantial public benefits on them, including exemption from certain state and local taxes and a line of credit with the Treasury, to do their jobs. Most other companies, banks, thrifts, and other lenders are chartered or created by a federal or state authority, not by Congress and do not enjoy these same advantages. Because of their public benefits and ties, the GSEs are able to undercut the prices of others in the marketplace.

For all of these reasons, the GSEs are subject to Congressional oversight. For the same reasons, they should be subject to strong regulatory review with clear guidance from Congress to assure they perform their missions and do not deviate from them at the cost of the private market.

Notably, the GSEs, at times, have encroached upon the private market, to the detriment of competitors and competition. In recent years HUD, for example, required Fannie Mae to cease its real estate owned (REO) management and disposition activities because those activities are beyond the GSE's charter. Those activities interfered with private market competitors who offer the same services.

MBA's longstanding view is Congress should ensure the regulator understands the distinction between the primary and secondary mortgage markets. The regulator should be given clear direction to review all GSE programs, products and activities to assure they are consistent with the GSEs' charters and applicable law. The regulator must be empowered to effectively review all new undertakings to assure they are in the public interest, are authorized, are safe and sound and do not distort the competitive landscape of the primary mortgage market.

Giving clear direction to review the GSEs' activities and establishing standards for such review regarding existing and new programs would provide more than mere clarity. It would go a long way to assuring competition in the future in both the primary and secondary markets.

We would add, however, MBA supports the ability of the GSEs to innovate to carry out their charter purposes. Such innovation is vital to the primary mortgage market. The new regulatory requirements must recognize this point and assure that the GSEs are able to make technological improvements within their sphere in a timely manner.

There are a number of ways to assure that the GSEs' purposes are carried out. Whatever means is chosen, Congress should be sure the legislative history indicates these authorities should indeed be fully carried out and that no negative inference should be gleaned from Congress's decision not to pursue any previous formulation of these authorities in earlier versions of this legislation.

VI. FUNDING

MBA believes the GSE regulator's budget should be funded through assessments on the regulated entities outside the appropriations process, as bank regulators are funded. An insufficient budget, pressured by the constraints of appropriations, as well as regulatory weaknesses have been a serious impediment to Fannie Mae's and Freddie Mac's regulators over the years.

VII. IMPROVEMENTS TO THE REGULATION OF THE FEDERAL HOME LOAN BANKS

The FHLBanks have a distinctive structure and an important housing role.

MBA strongly supports the FHLBanks and their advancing, mortgage and affordable housing programs. Several hundred of our member companies are members of FHLBanks and, for many of those institutions, their largest single investment is their stock in their FHLBank. Appropriate regulation of the Federal Home Loan Bank System is critical to our members and to the continued support of housing provided by the FHLBanks. MBA suggests the following be considered in establishing improvements to the regulation and oversight of the FHLBanks.

A. Any New Regulatory Structure Should Recognize the Distinctive Nature of the System

The Federal Home Loan Bank System has a major presence in global capital markets with $934 billion of consolidated obligations outstanding. The proceeds of those obligations are used to fund the $641 billion in advances outstanding to member institutions and to fund portfolio investments. The advances are collateralized and the collateral is largely residential mortgage loans. Through their advancing programs, the FHLBanks stimulate demand for mortgage loans and provide funds for them.

In addition to supporting community institutions by providing low-cost advances, the FHLBanks' advancing program supports housing. This support comes from the requirement that advances be collateralized, and almost all of that collateral is residential, single-family mortgage loans.

The FHLBanks, with assets of $1.02 trillion as of December 31, 2006, support housing in other ways as well. For example, they held over $100 billion in Fannie Mae, Freddie Mac and non-agency MBS at the end of 2005. The FHLBanks also held approximately $9 billion in debt of Fannie Mae, Freddie Mac, and state and local housing agencies. Finally, the Banks hold approximately $98 billion in residential mortgages through their MPP and MPF programs.

The FHLBanks differ from the other two GSEs in many ways, including some of the following major respects:

- **Structure:** Fannie Mae and Freddie Mac are shareholder-owned and publicly traded corporations. The Federal Home Loan Banks comprise a system of 12 institutions, each covering certain states and each cooperatively owned by member institutions in those states.

- **Profit Motivation:** As cooperatively owned institutions, the FHLBanks' primary focus is member service through their programs and, therefore, their businesses are less focused on maximizing profits than the other GSEs.

- **Membership Value:** Members receive dividends from the FHLBanks as well as beneficial advancing rates and the right to participation in the FHLBanks' mortgage purchase and affordable housing programs.

- **Scope of Mission:** The FHLBanks primarily support residential housing but they are also empowered to support economic development, including commercial, industrial, manufacturing, social service, and other projects.

Accordingly, any new regulatory structure should reflect the fact the FHLBank System is fundamentally different from Fannie Mae and Freddie Mac. Some of the bills introduced in previous Congresses have recognized this distinction to a greater or lesser degree. While MBA supports establishment of a single regulator to oversee Fannie Mae, Freddie Mac and the Federal Home Loan Bank System, a separate division should focus on the FHLBanks. MBA notes that S. 1100 and H.R. 1427 incorporate this provision.

B. Securitization Authority Should Be Made Explicit

In addition to their advancing programs and the collateral required to be held, the FHLBanks support housing through the billions of dollars they hold as investments in GSE mortgage-backed securities and in residential, single-family mortgages purchased through their Mortgage Purchase Program (MPP) and Mortgage Purchase Finance (MPF) programs. While these programs have shrunk in recent years to approximately $98 billion, they remain valuable to the mortgage market to a greater extent than their dollar volume might indicate. They provide important competition to the programs of the other GSEs.

The Federal Housing Finance Board has expressed concerns about the FHLBanks holding mortgages on their balance sheets. From a safety and soundness perspective, the primary tool to manage these assets would be securitization of these loans. However, concerns have been expressed that the FHLBanks may not have the authority to do so.

While MBA believes the Federal Home Loan Bank Act conveys adequate authority in this area, MBA thinks it would be useful to add clarifying language into the statute to expressly authorize this activity. Currently, this provision is not included in either the House or Senate GSE regulatory reform bills. Securitization would further increase competition in the secondary market benefiting home loan borrowers and renters with lower costs.

C. The FHLBanks' Affordable Housing Program Should Be Preserved

As a result of the FHLBanks' Affordable Housing Program, the Banks collectively are the largest donor organization to affordable housing in the nation. The program functions well, it achieves its purpose and is well administered. Considering the FHLBanks are doing their share to support affordable housing, MBA does not believe further intervention, such as attaching goals to eligible collateral or making the FHLBanks subject to other goals is necessary.

VIII. CONCLUSION

For the reasons described above, MBA believes regulation of the GSEs must be carried out by a strong, independent and well-funded entity with the resources and expertise to evaluate the GSEs' performance, both as financial institutions and as public purpose entities.

Together the secondary and primary mortgage markets have offered the needed financing to provide homeownership and affordable rental opportunities across the nation, which has been a driving force in establishing communities, creating financial stability and wealth for consumers and fueling the overall economy. Improved regulation of the GSEs, including the Federal Home Loan Bank System, if properly done, will help assure the vitality and the robust, competitive nature of both the primary and secondary mortgage markets for years to come.

The Mortgage Bankers Association appreciates the opportunity to present its views on these important issues. For your convenience, Appendix B presents a brief summary of MBA's positions on the key elements in current GSE reform legislation in the House and Senate. MBA will do all it can to help the Congress move forward to develop, and we hope shortly enact, effective, comprehensive, GSE legislation to provide effective safety and soundness and mission regulation for the GSEs and the FHLBanks.

APPENDIX A
Market Data and Information – Primary and Secondary Mortgage Markets

The most recent data on mortgage loans made by lenders in 2006 provided under the Home Mortgage Disclosure Act (HMDA) demonstrate the greatest and widest availability of mortgage finance in our nation's history. The data show that borrowers in virtually every area of the nation, of every race and ethnicity, and at every income level receive an array of credit opportunities.

Homeownership has fallen from its highest levels in history, but Americans are still building significant wealth. According to the Federal Reserve's Flow of Funds data, the value of residential real estate assets owned by households has increased from $10.3 trillion in 1999 to $21 trillion as of the third quarter of 2007, and aggregate homeowners' equity exceeds $10 trillion. According to the Fed's 2004 Survey of Consumer Finances, the median net worth for homeowners was $184,000. For renters, it was $4,000. Clearly, many homeowners have been successful in accumulating wealth, both by steadily building up equity through their monthly payments, and through the rate of home price appreciation we have seen in recent years.

More than a third of homeowners, approximately 34 percent, own their homes free and clear. Of the 66 percent of the remaining homeowners, 75 percent have fixed rate mortgages and 25 percent have adjustable rate mortgages (ARMs). Many of the borrowers with adjustable rate loans have jumbo loans,[10] indicating that they are wealthier.

There were approximately 14 million mortgage originations in 2006, based on HMDA data, worth a total of $2.5 trillion. Over $10 trillion in residential mortgage loans were outstanding at the end of the third quarter of 2007. This enormous amount reflects an increase from $5.1 trillion at the end of 2000, and $2.6 trillion outstanding in 1990. In 2006, there were $33 billion in multifamily property loan originations.

The confluence of several factors has contributed to the growth in credit opportunities for mortgage borrowers over the last 15 years. These factors include innovations in the mortgage market, resulting in the range of mortgage products available today including fixed-rate products and adjustable rate products as well as the "nontraditional."[11] They also include increased competition from a number of loan originators including mortgage companies, banks, credit unions and mortgage brokers.

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[10] Jumbo loans are loans that exceed the conforming loan limit, currently $417,000 for single family properties.

[11] Under the Federal Regulators' Nontraditional Guidance, nontraditional products include mortgages that may involve the deferral of principal and/or interest including interest only and payment option mortgages. Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

8,886 lenders reported under HMDA last year.[12] These lenders employ about 370,000 employees nationwide to meet borrowers' credit needs. An estimated 2,670 lenders originated multifamily loans.

The secondary market is made up of the following.

Fannie Mae and Freddie Mac currently guarantee MBS valued at approximately $3 trillion. Fannie Mae and Freddie Mac can only buy and securitize residential loans that meet charter act eligibility standards as to loan size and loan-to-value ratio. There are virtually no restrictions on the multifamily loans that the GSE may purchase. Fannie Mae and Freddie Mac maintain a very large presence in the secondary market. As indicated, they purchase or securitize approximately 70 percent of the single family conforming mortgage loans in the United States. Their share of the market for multifamily loans in 2005 was 27 percent.

Private-label MBS issuers, which are non-GSE securitizers, such as lenders and dealers, issued more than half of the mortgage-backed securities in 2005 and 2006, outpacing the GSEs. Private label issuers generally do not guarantee their MBS but publicly offered securities are subject to rating and senior investors receive a variety of other sources of credit enhancement. The loans backing private label MBS are typically ineligible for GSE purchase. Loans that are too big for Fannie Mae and Freddie Mac to purchase (jumbo loans), as well as subprime, low documentation, and other nonconforming mortgages are securitized by these issuers. In 2006, over $1.1 trillion in private-label MBS was issued, including jumbo, nonprime, Alt A, and other nonconforming mortgage products.

Government National Mortgage Association (Ginnie Mae) securitizes FHA-insured, Rural Housing Service (RHS) and Department of Veterans Affairs (VA) guaranteed residential and multifamily mortgage loans. Currently the outstanding balance of these securities is approximately $412 billion.

Federal Home Loan Banks hold government loans and conventional, conforming residential loans in the approximate amount of $98 billion. Like Fannie Mae and Freddie Mac, the FHLBanks have portfolios and they invest in Ginnie Mae, GSE and non-agency MBS.

Whole loan portfolio investors, including thrifts, banks, pension funds, and insurance companies, hold unsecuritized loans, both residential and nonresidential, for their own portfolios. The whole loan market is approximately $3.4 trillion today.

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[12] Banks that are exempt from HMDA reporting and Regulation C include institutions with less than $35 million in assets, are not in the home lending business or have offices exclusively in rural (nonmetropolitan) areas. Mortgage companies are required to report unless they extend less than 100 purchase or refinance loans a year or do not operate in at least one metropolitan area.

Appendix B

Summary of Mortgage Bankers Association Positions
Regarding Key Elements in
Current GSE Reform Legislation
(Senate and House)

PART I GSE BILLS COMPARED – PROVISIONS OTHER THAN AFFORDABLE HOUSING

SUBJECT	S. 1100 AS INTRODUCED APRIL 12, 2007	H.R. 1427 AS PASSED BY THE HOUSE MAY 22, 2007	COMMENTS
Significant Definitions	Regulated Entity – Fannie Mae, Freddie Mac, and the FHLBs. (Enterprise is defined in the 1992 Act as Fannie Mae, Freddie Mac, and their affiliates, and this definition does not change. In this document, enterprise means Fannie Mae and Freddie Mac, while regulated entity means the enterprises and the FHLBs.) Authorizing Statutes – Fannie Mae and Freddie Mac charter acts and the FHLB Act. The bill permits the Director to take enforcement action against entity-affiliated parties. This means: 1. officers, directors, employees, controlling stockholder, or agent for a regulated entity; 2. Shareholders, affiliates, consultants and joint venture partners that participate in the conduct of the regulated entity's affairs; this does not include FHLB members based on their advances or on their FHLB stock ownership; 3. Certain outsiders, such as attorneys and accountants, who participate in wrongdoing 4. Any "not-for-profit corporation that receives its principal funding, on an ongoing basis, from any regulated entity." (This could provide enforcement jurisdiction over the Fannie Mae and Freddie Mac foundations.) Finance Facility - The FHLB Finance Facility that this bill creates. Violation – "any action (alone or in combination with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation."	Regulated Entity – Fannie Mae, Freddie Mac, and the FHLBs. (Enterprise is defined in the 1992 Act as Fannie Mae, Freddie Mac, and their affiliates, and this definition does not change. In this document, enterprise means Fannie Mae and Freddie Mac, while regulated entity means the enterprises and the FHLBs.) Authorizing Statutes – Fannie Mae and Freddie Mac charter acts and the FHLB Act. The bill permits the Director to take enforcement action against regulated entity-affiliated parties. This means: 1. Officers, directors, employees, agent for a regulated entity or controlling shareholder of an enterprise; 2. Shareholders, affiliates, consultants and joint venture partners that participate in the conduct of the regulated entity's affairs; 3. Certain outsiders, such as attorneys and accountants, who participate in wrongdoing; 4. Any "not-for-profit corporation that receives its principal funding, on an ongoing basis, from any regulated entity." (This could provide enforcement jurisdiction over foundations.)	The definition of violation in S. 1100 is from 12 U.S.C. § 1813(v) in banking law. It closes many loopholes in enforcement cases. Entity-affiliated party or regulated entity-affiliated party is also drawn from banking law. It permits the Director to bring enforcement actions against, for example, outside attorneys and accountants. Banking agencies can reach these people but OFHEO today cannot. Without the definition of "violation," however, this definition may not serve its purpose of permitting the Director to reach outside attorneys and accountants. S. 1100 clarifies that FHLB members are not entity-affiliated parties merely because they get advances from or own stock in an FHLB. Other participation in the FHLBs' affairs would be required for enforcement authority to reach FHLB members.
Agency Structure and Ombudsman	Section 101 Establishes the Federal Housing Enterprise Regulatory Agency as an independent agency. It has generel regulatory authority over Fannie Mae, Freddie Mac, the FHLBs, and the Finance Facility. The Director "shall" exercise its general regulatory authority "including" its duties and authorities of § 1313, to ensure that the purposes of the revised 1992	Section 101 Establishes the Federal Housing Finance Agency as an independent agency. It has general supervisory and regulatory power over the regulated entities. The Director "shall" exercise its general regulatory authority "including" its duties and authorities of § 1313, to ensure that the purposes of the revised 1992 Act, the Authorizing Statutes, and other applicable	Under both bills, the Director could give program approval and oversight functions to the regulatory Deputy, to the Housing Mission and Goals Deputy, or to both.

PART I GSE BILLS COMPARED – PROVISIONS OTHER THAN AFFORDABLE HOUSING

SUBJECT	S. 1100 AS INTRODUCED APRIL 12, 2007	H.R. 1427 AS PASSED BY THE HOUSE MAY 22, 2007	COMMENTS
	Act, the Authorizing Statutes, and other applicable laws are carried out. The Agency is headed by a Director appointed by the president and confirmed by the Senate for a six-year term. The first Director is OFHED's Director until a successor is appointed. There are three Deputy Directors, one for Fannie Mae and Freddie Mac, one for the FHLBs, and one responsible for housing mission and goals of all the regulated entities. The Director divides functions between the Deputies. Section 103 adds § 1313A Creates the Federal Housing Enterprise Board (Board) to advise the Director. The Board has 4 members – the Secretaries of Treasury and HUD, the Chair of the SEC, and the Director, who chairs the Board. Any member may call a meeting, and the Board must meet quarterly. The Board testifies and the Director reports to Congress annually on the regulated entities' safety and soundness, "operational; status," and performance of their missions, and on the Agency's operations, resources, and performance. Section 105 Creates the position of Inspector General of the Agency.	laws are carried out. The Agency is headed by a Director appointed by the president and confirmed by the Senate for a five-year term. The first Director is OFHEO's Director until a successor is appointed. There are three Deputy Directors, one for Fannie Mae and Freddie Mac, one for the FHLBs, and one responsible for the housing mission and goals of all the regulated entities. The Director divides functions between the Deputies. The President can appoint the Director immediately, although the Agency is not created until a year after enactment. Section 103 adds § 1313B. Creates the Federal Housing Enterprise Board (Board) to advise the Director. The Board has 3 members – Secretaries of Treasury and HUD and the Director, who chairs the Board. Any Board member may call a meeting at any time, and the Board must meet quarterly. The Board testifies before Congress annually. The Board is subject to the Sunshine Act (5 U.S.C. § 552b.) The Director reports to Congress annually, including any assessments by Board members, on the regulated entities' safety and soundness, "operational status," and performance of their missions, and on the Agency's operations, resources, and performance. In addition, the report must cover the enterprises' housing goals compliance and the FHLBs' compliance with their community investment and affordable housing programs. Requires the Director to establish an Ombudsman, by regulation. The Ombudsman will consider complaints and appeals from regulated entities and from anyone with a business relationship with a regulated entity. The Director sets the Ombudsman's duties and authorities.	
Director's Duties	Section 102 replaces § 1313 The Director has two "principal duties" – first, to oversee the prudential operations of each regulated	Section 102 replaces § 1313 The Director has two "principal duties" – first, to oversee the operations of each regulated entity and	The House bill gives the Director a duty to "minimize the cost of housing finance" through all the regulated entities.

PART I GSE BILLS COMPARED – PROVISIONS OTHER THAN AFFORDABLE HOUSING

SUBJECT	S. 1100 AS INTRODUCED APRIL 12, 2007	H.R. 1427 AS PASSED BY THE HOUSE MAY 22, 2007	COMMENTS
	entity on a consolidated basis, and second, to ensure: 1. Safety and soundness; 2. That the regulated entities "foster liquid, efficient, competitive, and resilient" markets, including housing activities for low- and moderate-income families "involving a reasonable economic return that may be less than the return earned on other activities;" 3. That the regulated entities comply with the amended 1992 Act, the Authorizing Statutes, and rules, regulations, guidelines, and orders issued under those statutes; 4. The regulated entities carry out their mission only through activities that are consistent with this title and the authorizing statutes" 5. The regulated entities' activities "are consistent with the public interest"; 6. The regulated entities remain adequately capitalized "after due consideration of the risk to such" regulated entity; and 7. The FHLBs finance community financial institutions for small businesses, small farms, and small agribusinesses, and accept as collateral whole interests in "such obligations." The Director has authority to review the acquisition or transfer of a controlling interest in a regulated entity, and to reject it if warranted under the Director's principal duties. The Director also has incidental powers as "necessary or appropriate" to fulfill its duties and responsibilities. The Director may sue and be sued.	any joint office of the FHLBs (created pursuant to Section 204), and second, to "ensure" a list of things: 1. Safety and soundness; 2. That the regulated entities "foster liquid, efficient, competitive, and resilient" markets, that minimize the cost of housing finance including housing activities for low- and moderate-income families "involving a reasonable economic return that may be less than the return earned on other activities;" 3. that the regulated entities comply with the Act and with rules, regulations, guidelines, and orders issued under the Act or the Authorizing Statutes; 4. The regulated entities carry out their mission "only through activities that are consistent with this title and the authorizing statutes." The Director has authority to review acquisition or transfer of a controlling interest in Fannie Mae or Freddie Mac, and to reject it if warranted under the Director's principal duties. The Director also has incidental powers as "necessary or appropriate" to fulfill its duties and responsibilities. The Director may sue and be sued.	
Prudential Management and Operations Standards and Remedies for Non-Compliance	Section 108 adds § 1313B. This section states that the Director "may" establish standards, "by regulation, order, or guideline," for Fannie Mae and Freddie Mac relating to: 1. Adequacy of internal controls and information systems; 2. Independence and adequacy of internal audit systems; 3. Management of interest rate risk; 4. Management of market risk, including standards	Section 102 adds § 1313A. This section states that the Director "shall" establish standards "by regulation, guideline, or order," for Fannie Mae, Freddie Mac, and the FHLBs, relating to: 1. Adequacy of internal controls and information systems including information security and privacy policies and practices; 2. Independence and adequacy of internal audit systems; 3. Management of credit and counterparty risk;	The standards are optional under S. 1100 but are required under H.R. 1427. Item 10 in the H.R. 1427 list is not in S. 1100. The analogous bank provision is 12 U.S.C. § 1831p-1, "Standards for safety and soundness," although S. 1100 and H.R. 1427 are broader. The standards under S. 1100 are enforceable administratively or judicially. Under H.R. 1427, they are enforceable administratively if they are established through regulation. Otherwise, under

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	that measure, monitor, control, and, as warranted, limit market risk; 5. Adequacy and maintenance of liquidity and reserves; 6. Investments and acquisitions by an enterprise to ensure consistency with laws; 7. Overall risk management processes, including board and senior management oversight, processes and policies to identify, measure, monitor, and control material risks, including reputational risk, and for adequate and well-tested business resumption plans for all major systems with remote sites; 8. Management of asset and investment portfolio growth; and 9. Other operational and management standards the Director determines are appropriate.	4. Management of interest rate risk; 5. Management of market risk, including standards that measure, monitor, control, and, as warranted, limit market risk; 6. Adequacy and maintenance of liquidity and reserves; 7. Management of any asset and investment portfolio; 8. Investments and acquisitions to ensure consistency with laws; 9. Overall risk management processes, including board and senior management oversight, processes and policies to identify, measure, monitor, and control material risks, including reputational risk, and for adequate and well-tested business resumption plans for all major systems with remote sites; 10. Maintenance of adequate records in accordance with accounting practices that enable the Director to evaluate the regulated entities' financial condition; 11. Issuance of subordinated debt that the Director considers necessary for each regulated entity; and 12. Other operational and management standards the Director determines are appropriate. If there is a failure to meet a standard, the Director must (if the standard is a regulation) or may (if the standard is by guideline) require a compliance plan. Failure to comply with the plan may result in orders imposing growth restrictions, capital surcharges, or other measures. This section is in addition to any other authority. If the regulated entity has undergone "extraordinary growth" prior to the non-compliance, the Director's remedies become mandatory.	H.R. 1427, the Director can issue orders for violations of the standards, but orders in H.R. 1427 are enforceable only through civil money penalties, not through cease and desist orders and not judicially. Note that the remedies provided in the House bill under 1313 A are in addition to the broader cease and desist and other remedies in Subtitle D.
Liaison with FFIEC		Section 138 The Agency would be included in the Federal Institutions Examination Council.	The House bill provision would associate the GSE regulator with the other federal financial regulators on the FFIEC, a position that has been suggested by MBA and others.
Issuance of Regulations and Orders (General Regulatory Authority)	Sections 101, 107, and 121 Together these sections repeal HUD's general	Sections 101, 111 Together these sections repeal HUD's general	S. 1100, in § 107, includes "directives" in the list of alternative regulatory or other actions the Director

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	regulatory authority and give general regulatory authority to the Director. Section 107 Expands § 1319G, which currently requires OFHEO to issue regulations necessary to carry out the 1992 Act and OFHEO's duties. Requires the Director to issue regulations, guidelines, directives, or orders necessary to ensure the purposes of the amended 1992 Act and the Authorizing Statutes are carried out.	regulatory authority and give general regulatory authority to the Director. Section 111 Amends § 1319G, which currently requires OFHEO to issue regulations necessary to carry out the 1992 Act and OFHEO's duties. H.R. 1427 requires the Director to issue regulations, guidelines, or orders necessary to ensure the purposes of the amended 1992 Act and the Authorizing Statutes are carried out. Repeals current requirement that the Director give Congress 15 days to review regulations before proposing them.	can employ.
Workplace Diversity		Section 110 Each regulated entity must create an Office of Minority and Women Inclusion and shall develop and implement standards to ensure use of minorities, women and MWOBs in all of the activities of the regulated entity including contracting functions. The entities shall include in their annual reports to the Director a description of their actions taken in accordance with this section. The agency shall also take affirmative steps to seek diversity in its workforce at all levels of the agency consistent with the demographic diversity of the United States	No similar section in Senate bill.
Mortgagor Identification Requirements		All regulated entities, the enterprises and the FHLBs, are prohibited from dealing in any mortgage if the borrower does not have a Social Security Number.	The provision in the House bill calling for borrowers to have SSNs is directed at immigrant borrowers and is highly controversial.
Assessments	Section 106 Amends § 1316 to fully remove the Agency's funding from the appropriations process. The regulated entities are assessed for their regulatory costs based on their assets, both on- and off-balance sheet. The Director may impose a nonperiodic assessment on a regulated entity that is not adequately capitalized or that is subject to an enforcement or prompt corrective action, so that the extra costs of supervising that regulated entity are not passed on to other	Section 106 Amends § 1316 to fully remove the Agency's funding from the appropriations process. The regulated entities are assessed for their regulatory costs based on their assets. For the enterprises, this includes both on-balance sheet assets and securities issued or guaranteed, and for the FHLBs, it includes assets as the Director determines in accordance with GAAP. The Director may impose a nonperiodic assessment on a regulated entity that is not adequately capitalized	Removing the regulator from the Congressional appropriations process would solve a problem that has hampered GSE regulators. Assessments under S. 1100 would be enforceable, but under H.R. 1427, enforcement would have to be by administrative action, such as through cease and desist proceedings.

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	regulated entities. Authorizes the Director to maintain a working capital fund. GAO must annually report to Congress on how much the Director collects and on its allocation of resources. (§ 406.)	or that is subject to an enforcement or prompt corrective action, so that the extra costs of supervising that regulated entity are not passed on to other regulated entities. Authorizes the Director to maintain a working capital fund. The Director must file quarterly financial reports with OMB, and is subject to GAO audit at least every three years. The Director must provide an "assertion" about the effectiveness of the Agency's internal controls.	
Bright Line between GSE Secondary Market Functions and Primary Market Functions	No explicit provision, but see next entry.	Section 140 No explicit use of the term "bright line" but this section of the bill provides that the subpart of the law concerning mission regulation "may not be construed to authorize an enterprise to engage in any program or activity that contravenes or is inconsistent with the Fannie Mae Charter Act or Freddie Mac Act."	Sec. 140 and Sec. 132 of HR 1427 below empower the Director to stop new and ongoing GSE activities that contravene or are inconsistent with law
Mission Regulation Authority	Sections 121 Repeals HUD's authority over new programs. Section 122 Requires the Director to require the enterprises to obtain the Director's prior approval before initially offering any new product. The term product is defined *(1) to include* all programs, products and activities offered by the enterprise in the marketplace; and <u>(2) *not to include*</u>. a. The automated loan underwriting system (AUS) of an enterprise as of the date of enactment including any upgrade to its technology, operating system or software b. Any modifications to the mortgage terms and conditions or mortgage underwriting criteria relating to mortgages purchased or guaranteed by the enterprise, provided such modifications do not alter the underlying transaction so as to include services or financing, other than mortgage financing or create	Section 131 Repeals HUD's authority over new programs. Section 132 Requires the Director to require the enterprises to obtain the Director's prior approval before initially offering any new product. The term product is defined only by exclusion, to exclude (1) The automated loan underwriting system (AUS) of an enterprise as of the date of enactment including any upgrades to its technology, operating system or software (2) Any modifications to the mortgage terms and conditions or mortgage underwriting criteria relating to mortgages purchased or guaranteed by the enterprise, provided such modifications do not alter the underlying transaction so as to include services or financing other than residential mortgage financing or create significant new exposure to risk for the enterprise or holder of the mortgage.	S 1100 and HR 1427 are very similar in this area. Both bills make the Director responsible for reviewing "new products." Only the Senate bill, however, defines what a "product" is as well as what it is not and in doing so makes clear that the definition encompasses "all programs, products and activities offered by a GSE in the marketplace." Both S.1100 and HR 1427 define what a "new product" *is not* by exempting (1) the GSEs current automated underwriting systems and any upgrades as well as (2) any modification to mortgage terms or underwriting conditions relating to mortgages that are purchased or guaranteed by an enterprise from the definition of "product" and from the Director's review. MBA appreciates the drafters' interest in allowing innovation by the GSEs respecting their automated underwriting systems. However, the second exemption would establish a large and worrisome gap

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	significant exposure to risk. To get approval of a product, the enterprise must submit a written request in the form the Director prescribes, by order or regulation. "Immediately" upon receipt of a request for approval, the Director must publish notice of the application and "shall give interested parties the opportunity to respond" to the product in writing. The comment period is 30 days beginning on the date of publication. Within 30 days after the end of the comment period, the Director shall approve or deny the product and must specify the grounds for its decision. If the Director does not act in that time period, the enterprise may offer the product. Expedited review - If an enterprise determines that any new activity, service, undertaking, or offering is not a product, it must notify the Director before commencing it. "Immediately" upon receipt of such notice, the Director determines whether the proposed activity, service, undertaking or offering is a product. If so, the enterprise must get prior approval. For a product to be approved, the Director must determine that a product: • Is authorized under certain provisions of the charter Acts permitting enterprise programs to purchase, service, sell, lend on the security of or otherwise deal in mortgages, (the same provision in the standard for approval under current law) in current law); • Is in the public interest; • Is consistent with the safety and soundness of the enterprise or the mortgage finance system; and • Does not impair the stability or competitiveness of the mortgage finance system. The Director may approve any product conditionally or with limitations. Section provides that nothing in the section restricts the Director's safety and soundness authority, over all new and existing products or activities or the	To get approval of a product, the enterprise must submit a written request in the form the Director prescribes, by order or regulation. "Immediately" upon receipt of a request for approval, the Director must publish notice of the application and "shall give interested parties the opportunity to respond" to the product in writing The comment period is 30 days beginning on the date of publication. Within 30 days after the end of the comment period, the Director shall approve or deny the product and must specify the grounds for its decision. If the Director does not act in that time period, the enterprise may offer the product. Expedited review - If an enterprise determines that any new activity, service, undertaking, or offering is not a product, it must notify the Director before commencing it. "Immediately" upon receipt of such notice, the Director determines whether the proposed activity, service, undertaking or offering is a product. If so, the enterprise must get prior approval. For a product to be approved, the Director must determine that a product: • Is authorized under certain provisions of the charter Acts permitting enterprise programs to purchase, service, sell, lend on the security of or otherwise deal in mortgages, (the same provision in the standard for approval under current law); • Is in the public interest; • Is consistent with the safety and soundness of the enterprise or the mortgage finance system; and • Does not materially impair the efficiency of the mortgage finance system. The Director may approve any product conditionally or with limitations. Section provides that nothing in this section restricts the Director's safety and soundness authority, over all new and existing products or activities or the Director's authority to review all new and existing products or activities to ensure they are consistent	in the Director's authority. For example, if the GSEs were to develop a product that was harmful to borrowers, including possibly subprime borrowers, even if it was significantly different from current products, it could not be reviewed by the regulator. Current law, unlike the bills' provisions, allows HUD to review programs if they are significantly different and, therefore, would likely provide sufficient authority to review such a product when it was part of a new program. While the standards for review for new products under both bills are similar but there is one key difference. The Senate bill requires disapproval of a product if it "impairs the stability or competitiveness of the mortgage finance system." The House Bill requires disapproval if the product "materially impairs the efficiency of the mortgage finance system." MBA believes the Senate approach is the better formulation because it provides broader authority to the Director to assure that new products do not undermine the stability or competitiveness of the mortgage financing system encompassing both the primary and secondary markets. The Director will be required to publish notices of new products under both bills. Notably, the Director will not be able to publish information that causes competitive harm to the enterprises because of the *Trade Secrets Act*, 18 U.S.C. § 1905. This Act makes it a criminal offense for federal employees to disclose trade secrets or certain confidential information they come across in the course of their official duties, and will limit what the Director can publish. Both bills unfortunately retain the "clock" and provide that a product is approved if it is not disapproved

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	Director's authority to review all new and existing products or activities to ensura they are consistent with the enterprises' statutory mission.	with the enterprises' statutory mission.	within 30 days after the close of public comments While MBA appreciates the need to allow the GSEs to move forward to innovata without undue red tape, the Director should have latitude to extend the period of review in unusual circumstances. The fact that the Director may approve a product conditionally or with limitations helps ameliorate this concern.
Nonmission-Related Assets and Portfolios	Section 109 adds § 1369E States that Congress finds the portfolios of the enterprises should be focused on meeting affordable housing goals. Therefore bill provides all mortgages or MBS acquired must meet the housing goals or be securitized. The Director can make an exception to mitigate market disruptions.	Section 115 adds § 1369E Requires the Director to establish standards by which the portfolio holdings or rate of growth of the portfolio holdings of the enterprises will be deemed to be consistent with the mission and the safe and sound operations of the enterprises. The Director must consider: 1. Size and growth of the market; 2. Liquidity needs of secondary market; 3. Need for an inventory of mortgages in connection with securitizations; 4. Need for direct support for affordable housing; 5. Enterprises' liquidity needs; 6. Risks posed by the portfolios; and 7. Any additional factors that the Director determines to be necessary to carry out the purpose of establishing standards for assessing whether the portfolio holdings are consistent with the mission and safe and sound operations of the enterprises." Permits the Director to require an enterprise to dispose of assets or obligations in order to be consistent with the standards.	S. 1100 would place strict limitations on portfolio holdings of the enterprises, confining them to serving affordable housing goals. H.R. 1427 gives the Director some latitude to regulate portfolio assets for reasons of safety and soundness and mission.
Corporate Governance of Enterprises	No provision.	Section 116 A majority of the seated directors of each enterprise must be independent as the NYSE defines the term. Enterprise boards must meet at laast 8 times a year and not less than once each quarter. Non-management enterprise directors must regularly meet without management.	

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		A quorum for the enterprises is at least a majority of seated directors. Enterprise directors may not vote by proxy. There are requirements for management information to the board and for board committees. Each enterprise must administer a written code of conduct. CEO and CFO are liable for reimbursement in the event of a required restatement due to their misconduct under §304 of SOX. The CEO and CFO must make SOX certifications. Enterprise boards must oversee corporate strategy, major plens of action, risk policy, legal compliance, corporate performance and growth plans, among several other matters. Enterprise boards must also oversee "responsiveness of executive officers in providing accurate and timely reports to Federal regulators and in addressing the supervisory concerns of Federal regulators in a timely and appropriate manner." Each enterprise must have a compliance officer reporting to the CEO.	
Presidentially Appointed and Public Interest Directors	Sections 162 (enterprises) and 201 (FHLBs) Enterprises Each currently has 18 directors, 5 of whom are presidentially appointed. This bill eliminates the presidentially appointed directors and leaves the 13 stockholder-elected directors. Sitting presidentially appointed directors are to remain until the end of their one-year terms. The Director could set a different board size. The President no longer could remove a director for good cause. The boards still need to have one member from each of the following: community interests; banking services, credit needs, housing or financial consumer protection groups. FHLBs - Currently, the FHFB can appoint 6 directors for each FHLB, and its members elect the other directors. This bill sets the boards' sizes at 13 or such other number as the Director determines appropriate. All directors are elected by FHLB member vote.	Sections 181 (enterprises) and 202 (FHLBs) Enterprises. Each currently has 18 directors, 5 of whom are presidentially appointed. Under H.R. 1427, the boards would consist of thirteen persons or such other number that the director determines appropriate. Sitting presidentially appointed directors are to remain until the end of their one-year terms. FHLBs. Currently, the FHFB can appoint 6 directors for each FHLB, and its members elect the other directors. This bill sets the board for each FHLB at 13 directors or such other number as the Director determines appropriate. The Director also appoints at least 2/5 of each FHLB's directors ("independent directors") from a list recommended by the Federal Housing Enterprise Board. • A majority of directors of each FHLB must be an officer or director of a member bank of that FHLB's district. At least 2/5 of the directors of each FHLB	The Director/Regulator continues to select a minority of the board members of the regulated FHLBs – a system opposed by the current Chair of the FHFB and by MBA. Under S. 1100, procedures for nomination and election of independent directors are established by each FHLB. The regulator does not appoint independent directors, as it has under current law.

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	• A majority of each board has to be directors or officers of a member of the FHLB (member directors), and non-member directors have to be at least 1/3 of the board. • At least 2 of the non-member directors have to be public interest directors, that is, consumer or community representatives. • Directors must be U.S. citizens. • Deletes a requirement that the number of elected directors from each state must at least equal the number for that state in 1960. • Directors' terms are changed from 3 years to 4, and are staggered.	must be independent. Independent means they must reside in the district and may not serve as officer or director of any member. • At least 2 of the independent directors must be public interest directors, that is, from organizations representing consumer or community representatives. Other independent directors must have financial or management expertise. • Deletes a requirement that the number of elected directors from each state must at least equal the number for that state in 1960. • Directors' terms are changed from 3 years to 4, and are staggered. In appointing independent directors of an FHLB, the Director shall take into consideration the demographic makeup of the community most served by the Affordable Housing Program of the bank.	
SEC Registration	Section 111 Each regulated entity must register, and maintain registration of, at least one class of capital stock with the SEC. The enterprises must comply with the SEC rules for proxy solicitations and tender offers. Removes MBS and debt exemptions; including a provision specifying MBS swap counterparties are not issuers, underwriters or dealers under the Securities Act of 1933. Section 205 The FHLBs and their members are exempt from specified SEC rules. The SEC may issue regulations to implement these exemptions. The SEC is required to consider the FHLBs' distinctive characteristics when evaluating the accounting treatment of REFCORP payments, the role of the combined FHLB financials, the accounting classification of redeemable FHLB stock, and the accounting treatment of the joint and several nature of FHLB debt.	Section 117 Each regulated entity must register, and maintain registration of, at least one class of capital stock with the SEC. The enterprises must comply with the SEC rules for proxy solicitations and tender offers. Section 205 Permits Director to set regulations to "ensure" that each FHLB has access to information it needs "to determine the nature and extent of its joint and several liability. Provides that by this information sharing, or by permitting this information sharing, the Director does not waive any privilege. The FHLBs could, however, be required to waive privileges. Section 207 The FHLBs, their members, and securities are exempt from specified SEC rules. In issuing any regulations to implement these exemptions, the SEC shall consider the FHLBs' distinctive characteristics when evaluating the accounting treatment of REFCORP payments, the role of the combined FHLB financials, the accounting classification of redeemable FHLB stock, and the	S. 1100 requires the SEC to issue regulations within a year. Note that while MBS exemption is removed, MBS swap counterparties would not have underwriter liability. The FHLBs have advocated that, while they will have filed with the SEC, the "exempted securities" language be included to assure their securities (debt) are on par with that of the enterprises.

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		accounting treatment of redeemable capital stock and of the joint and several nature of FHLB debt.	
Compensation, Golden Parachutes and Indemnification Payments	Section 112 The Agency could, by regulation or order, prohibit or limit golden parachute or indemnification payments. Golden parachute payments are payments "in the nature of compensation" to "any affiliated party," pursuant to a regulated entity's obligation, that is contingent on that party's termination of affiliation with the regulated entity, and is made after the regulated entity becomes insolvent, has a conservator or receiver appointed, or the Agency determines the regulated entity is in a troubled condition. Troubled condition would be defined by regulation. The definition would also reach payments that precede but are in contemplation of the regulated entity's insolvency, conservatorship, receivership, or troubled condition. Payments under retirement plans and deferred compensation plans would still be permitted. Indemnification payments mean payments to or for the benefit of any affiliated party to reimburse the party for legal expenses to defend an enforcement action by the Agency that results in a final civil money penalty assessment, removal or prohibition order, or order requiring affirmative remedial action. It also includes a payment of a civil money penalty assessment, payment of a remedial action order, or any judgment. A regulated entity's purchases of directors' and officers' insurance is permitted, as long as the insurance does not pay actual penalties, remedial payments, or judgments. In prohibiting or limiting golden parachute or indemnification payments, the Director must consider factors that it prescribes by regulation. These factors may include: 1. Whether there is reason to believe the affiliated party engaged in fraud, breach of trust or fiduciary duty, or insider abuses that had a material affect on the regulated entity; 2. Whether there is reason to believe the affiliated	Section 108 The Director can prohibit unreasonable executive compensation at a regulated entity in cases of wrongdoing. The Director can require a regulated entity to withhold compensation during a review of its reasonableness and comparability. Expressly states that Director approval of a contract providing severance pay does not preclude the Director from prohibiting excessive compensation under § 1318(a).	H.R. 1472 does not amend § 1318(a) (prohibition of excessive compensation) to apply it to the FHLBs. However, it adds new § 1318(c) that permits the Director to require a regulated entity, including an FHLB, to withhold payment during a § 1318(a) review.

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	party is substantially responsible for the regulated entity's insolvency, conservatorship, or receivership; 3. Whether there is reason to believe the affiliated party materially violated a law that had a material affect on the regulated entity; 4. Whether the affiliated party was in a position of managerial or fiduciary responsibility; 5. How long the party was affiliated with the regulated entity. The regulated entities would not be permitted to prepay salary or legal expenses of any affiliated party in contemplation of, or after, insolvency to prevent, or with a view to preventing, the proper application of assets to creditors, or to prefer, or with a view to preferring, one creditor over another.		
Authority to Require Reports; Reports of Fraudulent Loans	Sections 104 and 113 Expands current authority of the Director, in § 1314, to require regular and special reports from the regulated entities on their condition and other matters the Director considers appropriate. The Director may require the regulated entities to submit fair value financials to the Director. Adds that the Director may require reports "by general or specific orders" for both regular and special reports. Also edds failure by a regulated entity to make reports as required and when required, or to submit or publish a false or misleading report, is subject to civil money penalties under § 1314 (not the regular civil money penalty authority). Penalty amounts may be up to $2000 per day in cases where the regulated entity shows the violation was inadvertent. If the violation was knowing or was with reckless disregard for reporting accuracy, penalties may be up to $2 million per day. Violations worse than inadvertent but not as egregious as knowing or with reckless disregard may be subject to penalties up to $20,000 per day. Requires the Director, by regulation, to require a report to the Director when a regulated entity discovers it has purchased or sold a fraudulent loan or financial instrument or suspects possible fraud relating	Sections 104 and 105 Expands current authority of the Director, in § 1314, to require regular and special reports from the regulated entities on their financial condition and other matters the Director considers appropriate. Requires the Director, by regulation, to require a report to the Director when a regulated entity discovers it has purchased or sold a fraudulent loan or financial instrument or suspects possible fraud relating to a purchase or sale of any loan or financial instrument. Other types of fraud are not covered. Regulated entities and regulated entity affiliated parties who make or require another to make any such report have "safe harbor" protection from liability in private lawsuits if the report is made in good faith. The Director must, by regulation, require the enterprises to disclose to the Director the "total" value of enterprise contributions to nonprofit organizations. If a contribution exceeds an amount the Director designates, the enterprise must disclose the recipient's name and the value of the contribution to that individual recipient. If a contribution exceeds an amount the Director designates and goes to a nonprofit where an enterprise director, officer, controlling person, or	Both bills require reports of fraudulent loans. The two bills are quite similar on this point. Both bills provide a safe harbor from defamation and similar claims. In H.R. 1427, the safe harbor only applies when the report is made in good faith. S. 1100 does not require a showing of good faith. The analogous safe harbor in the Bank Secrecy Act (that requires many financial institutions to report suspicious activities) does not require a showing of good faith. Under both bills, the safe harbor protects a regulated entity that makes "or requires another to make" a fraud report. This language implies that the regulated entities may require others to file the reports. However, under both bills the safe harbor does not reach lenders if the regulated entity requires the lender to file the report.

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	to a purchase or sale of any loan or financial instrument. Other types of fraud are not covered. Regulated entities and regulated entity affiliated parties who make or require another to make any such report have "safe harbor" protection from liability in private lawsuits.	spouse thereof, was a director or trustee, the enterprise must disclose the recipient's name and the value of the contribution to that individual recipient. The Director must make public the information submitted pursuant to this section.	
Examiners and Accountants	Section 105 Permits the Director to hire examiners, economists, accountants, and specialists in financial markets or in technology, for purposes of regulating the enterprises, outside of the competitive service. Creates the office of Inspector General.	Section 107 "Each" examination must review a regulated entity's procedures for reporting fraudulent loans. Permits the Director to hire examiners, accountants, and economists for regulating the regulated entities outside of the competitive service.	S. 1100 includes, in the list of hires outside competitive service, specialists in financial markets and in technology.
Reviews of Enterprises	Section 105 Deletes "by rating organization" from the heading, but not the text, of § 1319. This section permits the Director to have a rating organization review Fannie Mae and Freddie Mac.	Section 109 The Director can require a review of any regulated entity by any appropriate party.	Examiners themselves can review any of the regulated entities.
Risk-Based Capital Test	Section 110 Repeals OFHEO's statutory risk-based capital stress test. Requires the Director to establish risk-based capital requirement, by regulation or order, for the enterprises, to ensure that they operate safely and soundly "with sufficient capital and reserves to support the risks that arise in the[ir] operations and management." OFHEO's existing risk-based capital regulation remains in effect until the Director revises it. States that the risk-based capital authority does not limit the Director's authority to impose other requirements. Amends the risk-based capital requirement of § 6 of the FHLB Act to permit the Director flexibility in setting minimum capital levels.	Section 113 Requires the Director to set a risk-based capital requirement for the regulated entities, by regulation. The requirement with regard to the regulated entities must be sufficient "to support the risks that arise in the operations and management of" the regulated entities. The requirement for the enterprises could be different from that for the FHLBs under Section 6 of the FHLB Act. OFHEO's existing risk-based capital regulation remains in effect until the Director revises it. Extends the provision on confidentiality of information to cover all of the regulated entities, including the FHLBs. This provision makes confidential any information anyone receives, whether from the Director or a regulated entity, to enable the risk-based capital standards to be applied. Exempts all such information from FOIA disclosure.	Both bills provide flexible authority to set risk-based capital requirements. S. 1100 permits increased requirements by order as well as by regulation, close to banking law.
Minimum and Critical Capital Levels	Sections 110 and 141 Retains the current minimum capital requirement for the enterprises, but permits the Director to increase it	Section 114 Retains the current minimum capital requirement for all regulated entities. Permits the Director to increase	S. 1100 is similar to banking law, which permits banking regulators discretion to impose capital

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	"by regulation or order[.]" It would not have to be a percentage of assets or off-balance sheet items, as it is today. For the FHLBs, retains the current leverage requirement in the FHLB Act, but the Director may increase it "by regulation or order[.]" Critical capital requirements for the enterprises are to be the existing requirement or any other level the Director establishes by regulation. New requirements could go up or down. The requirements do not have to be a percentage of assets or obligations, as under current law, but could be risk-based. The Director shall establish critical capital requirements for the FHLBs by regulation.	this requirement, by regulation. The Director may impose temporary surcharges if: • The regulated entity is in an unsafe or unsound condition or faces a rapid capital depletion, or, for the enterprises only, the value of mortgages it holds or securitizes has decreased significantly; or • A regulated entity is operating in an unsafe and unsound manner because of violation of a prudential operating standard. Unless renewed, the temporary increase shall not remain in place for more then six months. The Director may "at any time by order or regulation" increase the capital requirements for "any program or activity" to ensure that the reguleted entity has capital "to support the risks that arise in the operations and management of the regulated entity." Retains the current critical capital requirement for the enterprises. Adds authority to set critical capital requirements for the FHLBs "as the Director shall, by regulation require." The Director must consider the critical capital requirements for the enterprises and make appropriate modifications to reflect the differences between the enterprises and the FHLBs. FHLB critical capital regulation must be final within 180 days after the new law's effective date (one year after enactment). The Director must periodically review the capital levels and requirements.	surcharges on individual institutions as "necessary or appropriate" without a rulemaking. *See* 12 U.S.C. § 3907(2).
Capital Classifications	Section 142 Retains the four existing capital classifications that OFHEO uses – adequately capitalized, undercapitalized, significantly undercapitalized, end critically undercapitalized. Does not apply the classifications to the FHLBs. Broadens existing discretionary authority for the Director to lower a regulated entity's classification one level, and does apply this to the FHLBs. OFHEO can lower a classification when a regulated entity engages in conduct not approved by the Director that could result in a rapid depletion of core capital, or when	Section 151 Retains the four existing capital classifications that OFHEO uses – adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. They apply to the FHLBs, but the Director may modify the classification criteria as appropriate to reflect the differences between the enterprises and FHLBs. Regulations to implement the FHLB classifications ere due within 180 days of enactment. Broedens existing discretionary authority for the Director to lower a regulated entity's classification one	The bills are very similar. S. 1100 removes consideration of compliance with the risk-based capital requirement from the lowest two classifications.

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	there is a significant decrease in the value of mortgages that the regulated entity holds or has securitized. This bill: • Deletes the requirement that a core capital depletion must result from conduct not approved by the Director. • Adds that a significant decrease in the value of "collateral pledged" can suffice, even if the collateral is unrelated to mortgages. This could encompass collateral behind derivatives. • Adds that a lower classification may be based on an unsafe or unsound condition, after notice and hearing. • Adds that the Director mey lower a classification if the Director determines that the regulated entity is engaging in an unsafe or unsound practice based on an unsatisfactory examination report rating for credit risk, market risk, operations, or corporate governance. Prohibits dividends that make a regulated entity undercapitalized, but the Director can override this to permit dividends in some circumstances. Amends the classification criteria slightly. • "Adequately capitalized "stays at meets all capital requirements. • "Undercapitalized" stays at fails risk-based but meets minimum requirements. • "Significantly undercapitalized" still means the regulated entity fails minimum and meets critical, but risk-based requirement is irrelevant. Under current law, an enterprise is not significantly undercapitalized if it meets its risk-based requirement. • "Critically undercapitalized" still means fails critical requirement, but risk-based requirement is irrelevant. Under current law, an enterprise is not critically undercapitalized if it meets its risk-based requirement.	level for any regulated entity. OFHEO can lower a classification when a regulated entity engages in conduct not approved by the Director that could result in a rapid depletion of core capital, or when there is a significant decrease in the value of mortgages that the regulated entity holds or has securitized. This bill: • Deletes the requirement that a capital depletion must result from conduct not approved by the Director. • Retains current law that permits reclassification, of an enterprise only, if the value of mortgages held or securitized has decreased significantly. • Adds that a lower classification may be based on an unsafe or unsound condition, after notice and hearing. • Adds that the Director may lower a classification if the Director determines that the regulated entity is engaging in an unsafe or unsound practice based on an unsatisfactory examination report rating for asset quality, management, earnings, or liquidity. Prohibits dividends that make a regulated entity undercapitalized, but the Director can override this to permit dividends in some circumstances. Requires that the Director shall periodically review the amount of core capital maintained by the enterprises, the amount of capital retained by the FHLBs and the minimum capital levels established for the regulated entities under this section. The Director must rescind any temporary minimum capital level increase if the Director determines that the circumstances or facts justifying the temporary increase are no longer present.	
Supervisory Actions Applicable to	Section 143 – Undercapitalized regulated entity	Section 152 – Undercapitalized regulated entity	Both bills give the new regulator stronger powers

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Undercapitalized Regulated Entity	Requires the Director to closely monitor an undercapitalized regulated entity and its capital restoration plan; restricts asset growth unless the Director has accepted its capital restoration plan and an increase in total assets is consistent with the plan such that the enterprise can become adequately capitalized in a reasonable time. An undercapitalized regulated entity may not, directly or indirectly, acquire any interest in any entity or engage in any new activity without approval of the Director. The Director may take any of the actions authorized with respect to a significantly undercapitalized regulated entity if the Director determines such actions are necessary to carry out the purposes of the subtitle.	Requires the Director to monitor closely an undercapitalized regulated entity and its capital restoration plan; restricts asset growth unless the Director has accepted the capital restoretion plan, an increase in total assets is consistent with the plan, and total capital-to-assets increases such that the enterprise can become adequately capitalized in a reasonable time. An undercapitalized regulated entity may not, directly or indirectly, acquire any interest in any entity or engage in any new program or new business activity without the Director's approval. The definition of new business activity is the same as under amended § 1321 (see mission regulation authority above). The Director may take any of the actions authorized with respect to a significantly undercapitalized regulated entity if the Director determines such actions are necessary to carry out the purposes of the subtitle.	than OFHEO currently has to handle an undercapitalized enterprise. OFHEO today can require capital restoration plans and restrict dividends. OFHEO can classify the enterprise as significantly undercapitalized by finding that the enterprise fails to file, or fails to make good faith, reasonable efforts to comply with, a capital restoration plan.
Supervisory Actions Applicable to Significantly Undercapitalized Regulated Entity	Section 144 – Significantly undercapitalized regulated entity Applies to all the regulated entities OFHEO's current authority to require capital plans and to restrict dividends. Requires the Director to take one or more of the actions that today are within OFHEO's discretion to take. Gives the Director new authority to order election of a new board for a regulated entity, dismiss directors or executive officers, and require the regulated entity to employ qualified executive officers. Gives the Director new authority to take other actions that the Director "determines will better carry out the purposes of this section[.]" Requires the Director's approval before the regulated entity may give a bonus or raise to executive officers.	Section 153 – Significantly undercapitalized regulated entity Retains OFHEO's current authority to require capital plans and to restrict dividends. Requires the Director to take one or more of the actions that today are within OFHEO's discretion to take. Gives the Director new authority to order election of a new board for the regulated entity, dismiss directors or executive officers, and require the regulated entity to employ qualified executive officers. Gives the Director new authority to take other actions that the Director "determines will better carry out the purposes of this section[.]" Requires the Director's approval before the regulated entity may give a bonus or raise to executive officers.	Both bills give the new regulator stronger powers than OFHEO currently has to handle a significantly undercapitalized enterprise. Today OFHEO must require capital restoration plans and restrict dividends, and it has discretion to limit debt, growth, or terminate, reduce or modify any activity that creates excessive risk. OFHEO can classify the enterprise as critically undercapitalized by finding that the enterprise fails to file, or fails to make good faith, reasonable efforts to comply with, a capital restoration plan.
Conservators and Receivers	Section 145 Authorizes the Director to appoint the Agency as either conservator or receiver for Fannie Mae, Freddie Mac, or an FHLB.	Section 154 Authorizes the Director to appoint the Agency as either conservator or receiver for Fannie Mae, Freddie Mac, or an FHLB. Appointment is discretionary unless the Director determines that a state of asset –	Any mortgage, pool, or interest in a pool, held, in a trust, i.e., MBS, is specifically bankruptcy remote and held for the benefit of creditors. See new section 1367 (b)(19)(B).

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	Mandatory receivership Mandates receivership when, for 30 days a regulated entity: • Has had essets less than its obligations, or • Has not been generally paying its debts. When a regulated entity is critically undercapitalized, the Director must determine monthly whether receivership is mandated. Grounds for appointment • Substantial dissipation of assets or earnings due to violation of law or unsafe or unsound practice; • Unsafe or unsound condition to transact business; • Willful violation of final cease and desist order; • Concealment of books, records, or assets; • Likely inability to pay obligations in the normal course of business; • Actual or likely losses that will deplete all or substantially all capital, and there is no reasonable prospect of becoming adequately capitalized; • Violation of law or unsafe or unsound practice that is likely to cause insolvency or substantial dissipation of assets or earnings, or to weaken the enterprise; • Consent; • Regulated entity is undercapitalized or significantly undercapitalized and: has no reasonable prospect of becoming adequately capitalized, fails to become adequately capitalized, or fails to submit or materially implement a capital plan; • Regulated entity is critically undercapitalized; or • Regulated entity is convicted of money laundering. Powers As either conservator or receiver, the Agency may operate the enterprise and perform all functions consistent with a conservatorship or receivership. If there is a receiver, the Agency shall place the regulated entity in liquidation, which may include	insufficiency or failure to pay creditors has gone on for 30 days – and then the receivership is mandatory. Grounds for appointment • Assets are less than obligations; • Substantial dissipation of assets or earnings due to violation of law or unsafe or unsound practice; • Unsafe or unsound condition to transact business; • Willful violation of final cease and desist order; • Concealment of books, records, or assets; • Likely inability to pay obligations in the normal course of business; • Actual or likely losses that will deplete all or substantially all capital, and there is no reasoneble prospect of becoming adequately capitalized; • Violation of law or unsafe or unsound practice that is likely to cause insolvency or substantial dissipation of assets or earnings, or to weaken the enterprise; • Consent; • Regulated entity is undercapitalized or significantly undercapitalized and: has no reasonable prospect of becoming adequately capitalized, fails to become adequately capitalized, or fails to submit or materially implement e capital plan; • Regulated entity is critically undercapitalized; or • Regulated entity is convicted of money laundering. Powers As either conservator or receiver, the Agency may operate the enterprise and perform all functions consistent with a conservatorship or receivership. If there is a receiver, the Agency may place the regulated entity in liquidation, having due regard to tha conditions of the housing finance market. Both conservators and receivers, in selling assets, must conduct their operations in a manner that maintains stability in the housing finance merkets, and to the extent consistent with that goal, must maximize the return, minimize losses, and ensure "adequate competition and fair and consistent treatment of offerors." Who gets what	H.R. 1427 would permit a limited-life regulated entity, subject to the Director's approval, to issue debt with a super-priority lien, and otherwise to manage agency debt and MBS, and to issue new debt or equity securities for previously existing debt or MBS.

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	selling assets or transferring assets to a limited-life regulated entity, or exercising other Agency rights. A receiver must organize a limited-life regulated entity. Appointment of a receiver terminates all claims stockholders and creditors have against the regulated entity's assets or charter or against the Agency, except to their rights to payment specified in the bill. A regulated entity's assets do not include its charter. Both conservators and receivers, in selling assets, must maximize the return, minimize losses, and ensure "adequate competition and fair and consistent treatment of offerors." Who gets what A receiver may determine which claims against an enterprise are valid. The receiver, in its discretion, and to the extent funds are available from the assets of the regulated entity, may pay allowed claims. The receiver may also pay dividends on claims, from the assets of the regulated entity. Mortgages held in trust, custodial, or agency capacity for the benefit of any person other than the enterprise are only available to MBS holders. Unsecured claims and expenses of the receiver get paid in this order: • The receiver's administrative expenses. These include "actual, necessary costs and expenses" the receiver incurs in preserving the assets, or in liquidating or otherwise resolving the affairs of a failed regulated entity. They include obligations a receiver determines are "necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the regulated entity." • General or senior debt. • Junior debt. • Shareholders. Limited life regulated entity If the Agency is appointed receiver of: • An FHLB, the Agency "may" organize a limited-life regulated entity for FHLB in default or in danger of	A receiver may determine which claims against an enterprise are valid. The receiver, in its discretion, and to the extent funds are available from the assets of the regulated entity, may pay allowed claims. The receiver may also pay dividends on claims, from the assets of the regulated entity. Mortgages held in trust, custodial, or agency capacity for the benefit of any person other than the regulated entity are only available to MBS holders. Unsecured claims and expenses of the receiver get paid in this order: • The receiver's administrative expenses. These include "actual, necessary costs and expenses" the receiver incurs in preserving the assets, or in liquidating or otherwise resolving the affairs of a regulated entity. They include obligations a receiver incurs after being appointed, as "necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the regulated entity." • General or senior debt. • Junior debt. • Shareholders. Limited life regulated entity When a regulated entity is in default or the Agency anticipates it will default, the Agency may organize a limited-life entity. The Director "shall" grant the limited-life entity a temporary charter. This bill does not define the term "default." The Agency "may" grant a temporary charter if the Agency finds that continued operation of a regulated entity in default or in danger of default is "in the best interest of the national economy and the housing markets." This bill does not define the term "in danger of default." The Agency decides which assets and liabilities of a regulated entity in default or in danger of default to transfar to the limited-life regulated entity. Unless Congress authorizes a sale of stock of the limited-life regulated entity, it would last for 2 years, which the Director may extend for 3 additional 1-year	

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	default. If so, the Director "shall" grant a temporary charter to the limited-life regulated entity. A regulated entity is in default when a conservator or receiver or legal custodian is appointed. A regulated entity is in danger of default when, in the Agency's opinion, the FHLB: is unlikety to pay its obligations in the normal course of business; has incurred or is likely to incur losses that will deplete all or substantially all of its capital; and there is no reasonable prospect its capital will be restored. • An enterprise, the Agency "shall" organize a limited life-regulated entity. That entity succeeds to the preexisting enterprise charter. The Agency decides which assets and liabilities of a regulated entity in default or in danger of default to transfer to the limited-life regulated entity. The Agency shall wind up the affairs of the limited life regulated entity within two years, although the Director may extend the period for 3 additional 1-year periods. If the Agency sells at least 80% of the stock of a limited-life regulated entity, it ceases to be limited-life. The Agency is not required to sell stock, except that if it sells at least 80% of the stock of a limited-life regulated entity with respect to an enterprise, the Agency must sell any remaining stock within 1 to 3 years. The limited-life regulated entity can issue unsecured debt. If it is unable to do so, the Director can authorize the limited-life regulated entity to incur new debt that has priority over ""all the obligations" of the limited-life regulated entity, or to incur debt that is secured by a junior lien or by a lien on property that has no other lien. The Director can authorize the limited-life regulated entity to incur debt secured by a senior or equal lien (except not by a senior or equal lien on mortgages that back MBS the regulated entity issued or guaranteed) when the limited-life regulated entity is otherwise unable to obtain "such" credit and there is "adequate protection" for others who have liens on the same collateral. The Director must hold a hearing	periods. The Agency must wind up the limited-life regulated entity if its time expires. In other words, Congress has as long as 5 years to prevent the end of the regulated entity. The limited-life regulated entity can issue unsecured debt. If it is unable to do so, the Director can authorize the limited-life regulated entity to incur new debt that has priority over "administrative expenses," or that is secured by a junior lien or by a lien on property that has no other lien. The Director can authorize the limited-life regulated entity to incur debt secured by a senior or equal lien (except not by a senior or equal lien on mortgages that back MBS the regulated entity issued or guaranteed) when the limited-life regulated entity is otherwise unable to obtain "such" credit and there is "adequate protection" for others who have liens on the same collateral. The Director must hold a hearing first, and has the burden of proof. If any such authorization to issue debt or to create a prior lien is reversed or modified on appeal, the debt incurred or prior lien created is not affected as to any party who acted in good faith, even if the party knew there was an appeal pending, as long as the authority to incur debt or create a prior lien was not stayed pending appeal. A limited-life regulated entity may, "subject to" the Director's approval and conditions, issue debt "to which all other debt obligations of the limited-life regulated entity shall be subordinate in right and payment." This would not necessitate the hearing and other limitations described above. A limited-life regulated entity may, in addition to any other powers: • "extend a maturity date or change an interest rate or other terms of outstanding securities;" and • Issue securities in exchange for existing securities, claims, interests, or "for any other appropriate purposes[.]" The Director may not revoke a regulated entity's	

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	first, and has the burden of proof. If any such authorization to issue debt or to create a prior lien is reversed or modified on appeal, the debt incurred or prior lien created is not affected as to any party who acted in good faith, even if the party knew there was an appeal pending, as long as the authority to incur debt or create a prior lien was not stayed pending appeal. A receiver may not revoke an enterprise charter.	charter.	
Enforcement Provisions			Both bills give the Director enforcement authority more like that of the banking agencies than what OFHEO has today. Only S. 1100 would bring the enforcement authority up to par with the enforcement authority federal banking agencies have.

PART II GSE REFORM BILLS COMPARED – AFFORDABLE HOUSING PROVISIONS

SUBJECT	S. 2391 AS INTRODUCED NOVEMBER 16, 2007	S. 1100 AS INTRODUCED APRIL 12, 2007	H.R. 1427 AS PASSED BY THE HOUSE MAY 22, 2007
Affordable Housing Reports	Section 1324 The Secretary shall prepare and submit to Congress annually a new report concerning the activities of each anterprise including (1) the extent and manner in which each GSE is achieving the housing goals, is complying with the duty to serve underserved markets and is achieving the statutory purposes. In collecting data for this report, the Director shall identify activities involving subprime loans and compare the subprime loans purchased by the enterprises to other loans purchased by enterprises. To assist in preparing the new report, the Secretary shall conduct monthly surveys of mortgage markets, including data on individual mortgages eligible for purchase by the enterprises as well as those not eligible for purchase. This would involve data on house prices, loan to value ratios, mortgage terms, borrower creditworthiness, etc. The Secretary must also collect data on individual subprime mortgages and borrowers and determine whether the borrowers would qualify for prime loans.		Section 134 The Director shall prepare and submit to Congress annually a new report concerning performance and activities against housing goals as well as a number other studies including studies that (1) "examine the primary and secondary multifamily housing mortgage markets" and factors inhibiting standardization and securitization, (2) examine actions taken for first-time homebuyers, (3) analyze pricing trends, and (4) compare the subprime loans purchased by the enterprises to other loans purchased by anterprises. To assist in preparing the new report, the Director shall conduct monthly surveys of mortgage markets, including data on individual mortgages eligible for purchase by the enterprises as well as those not eligible for purchase. This would involve data on house prices, loan to value ratios, mortgage terms, borrower creditworthiness, etc. The Director shall issue regulations defining "subprime" but only for the purposes of this section. Section 135 To obtain information helpful in applying the formula for the Affordable Housing Fund, the regulated entities must conduct an annual study "to determine the levels of affordable housing inventory, and the changes in such levels, in communities throughout the United States." Results of the study must be made public.
Mortgagor Identification	No similar provision	No similar provision	Section 136 The Director must issue regulations prohibiting the enterprises from dealing with any mortgage on a 1-4 family residence unless the mortgagor has a social security number.
Affordable Housing Goals	Section 1331 - 1334 The Secretary, in implementing the goals, shall	Section 124 Transfers authority from HUD to the Director for	Section 137 The Director, in implementing the goals, may

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	review data to assess disparities between interest rates on loans to minorities and nonminorities of similar creditworthiness. If a pattern of disparities exists, the Secretary must refer the finding to the appropriate Congressional committees and require the enterprise to undertake remedial action, if appropriate. Repeals existing goals and replaces them with six single-family goals and one multifamily goal. Goals are annual. There are also multifamily "special requirements." <u>Single-family goals.</u> The single-family goals are: • Low-income families (80% of area median income (AMI)) • Families in low income areas, and • Very low income families (50% AMI) Qualifying loans are <u>purchase money</u>, conventional, conforming, and the property must be owner-occupied. The goals have to be set as a percentage of the enterprises' business. In setting the goals, the Secretary shall consider (1) national housing needs, (2) economic, housing and demographic conditions (3) the performance of the GSEs in previous years, (4) the ability to "lead the industry", (5) recent HMDA data, (6) the size of the conventional market, and (7) the need to maintain the GSE's sound financial condition. For goals purposes, borrower income is measured as of origination. <u>Single-family refinance goals</u> These goals mirror the single family goals above except they relate to loans to pay off or prepay an existing loan for each of the three categories. <u>Multifamily goal</u> There is one multifamily goal, which includes: • Loans on units for very low-income families, (50% AMI); and	affordable housing goals. Retains HUD's authority for fair housing. Section 127 Requires the Director, by regulation, to require the enterprises to make public the same information on single-family loans that HMDA requires lenders to report. Retains the three existing goals with some modifications, adds a home purchase goal, permits the Director to establish new goals and to modify or rescind the existing goals. The three existing goals remain, but some of the underlying definitions are changed. • <u>The low- and moderate-income (LMI) goal</u> currently requires the enterprises to buy loans on housing for LMI families, defined as families at or below 100% of area median income (AMI). This bill would lower the LMI definition to no more than 80% of AMI. • <u>The special affordable goal</u> currently requires the enterprises to purchase loans on housing for low-income families in low-income areas, and loans to very low income families. This bill would leave the goal in place but change the definitions, as follows: o Low-income would change from 80% of AMI to 50%; o The definition of median income would change also. Currently, median income is set by "areas" that HUD defines. The definition would change to be set as median income for a metropolitan statistical area (MSA) for families in MSAs, and for other families, the statewide non-metropolitan median family income. • <u>The underserved areas goal</u> currently requires the enterprises to buy loans on housing for families in central cities, rural areas, and other underserved areas. This bill would add a	review data to assess disparities between interest rates on loans to minorities and nonminorities of similar creditworthiness. If a pattern of disparities exists with respect to any lender or lenders, the Director must refer the finding to the appropriate regulatory or enforcement agency, require the enterprise to submit additional, relevant data on a lender or lenders, and require the enterprise to undertake remedial action, if appropriate. Repeals existing goals and replaces them with three single-family goals and one multifamily goal. Goals are annual. There is also one single-family subgoal, and there are multifamily "special requirements." <u>Single-family goals.</u> The single-family goals are: • Low-income families (80% of area median income (AMI)) • Families in low income areas, and • Very low income families (50% AMI) Qualifying loans are <u>purchase money</u>, conventional, conforming, and the property must be owner-occupied or 1-4 rental. The goals have to be set as a percentage of the enterprises' business. They are set at a base level, and the Director has some authority to raise them and lower them. The base level for each goal is set at the same percentage that loans qualifying for that goal are of the entire market. That is, if low-income loans make up X% of the market, the low-income base goal is X%. The percentage is measured using the average percentage for the three most recent years for which HMDA data are public. The market is defined as conventional, conforming, single-family, owner-occupied and 1-4 family rental, purchase money loans. For goals purposes, the Director determines what a conforming loan is by the original principal balance as reported in HMDA data. Borrower income is

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	• Loans on dwelling units assisted by low-income housing tax credits. It is unclear whether there are two subgoals within the goal. The Secretary may give full credit toward the goal for qualifying dwelling units financed by bonds (taxable or not) that state or local housing finance agencies issue, but only if the enterprise either: guarantees the bond; or purchases it and it is not investment grade. (There is no prohibition against a GSE receiving full credit for private MBS regardless of whether the securities are investment grade, as under current law.) The Secretary would have to create "additional requirements" for small multifamily housing projects. Small may be based on number of units (5 to 50) or loan size (up to $5 million). Among the factors used to set the multifamily goal, must be the ability of the enterprise to lead the industry in underserved markets "such as for small multifamily projects, multifamily properties in need of preservation and rehabilitation and multifamily properties located in rural areas". For the multifamily goal, income must be measured by the income of actual or prospective tenants if data are available, and otherwise by rent levels affordable to low-income and very low-income families. A rent level is affordable for its income category if the rent level is no more than 30% of the top of that income category, adjusted for unit size. In establishing the multifamily goal, the Secretary may consider loans on single-family rental housing purchased by an enterprise. Decreases in goals Upon petition by an enterprise (but not others), the Secretary may reduce any goal, but not an additional requirement, only if: • Reduction is required by market and economic	definition of "underserved." (This new definition applies only to this goal, and not to the home purchase goal, or to the housing duties described in the next entry.) An underserved area is an urban cansus tract with "average media n" income less than 80% of area median income, or an urban census tract with median family income less than area median and a minority population of at least 30%. Section 129 There is a new home purchase goal for owner-occupied single-family homes. The Director sets it by regulation. It must be annual, and may have "components," including for first-time homebuyers, LMI borrowers, homebuyers in central cities and in rural and other underserved areas and homebuyers who finance through state or local affordable housing programs. Components are enforceable. The Director can add, modify, or rescind goals to address national housing needs where the housing need is greatest. The goals could be set as percentage-of-business, as dollar goals, or by other means. In any event, the goals would need to be consistent with the enterprises' missions and authorizing statutes. Enforcement authority. The Director would have somewhat more enforcement authority compared to current law. Currently, if HUD determines that an enterprise has failed a goal or that failure is probable, it gives written notice to the enterprise, which has an opportunity to respond in writing. HUD considers the response, and determines whether the enterprise has failed or will probably fail a goal that is feasible to meet. HUD then requires the enterprise to submit a housing plan describing how the enterprise will come into compliance. Failure to submit or comply with the plan can be the basis for a cease and desist order or civil money penalty. Failure to meet a goal, alone, cannot be the basis	measured as of origination. Single-family subgoals These goals, which are subgoals of each of the single family goals, are for the refinance of owner-occupied or 1-4 rental units. The subgoals are enforceable in the same manner that the goals are enforceable. Multifamily goal There is one multifamily goal, which includes: • Loans on dwelling units for low-income families (80% AMI) • Loans on units for very low-income families, (50% AMI) and • Loans on dwelling units assisted by low-income housing tax credits. It appears that there are three subgoals within the goal. The Director must give full credit toward the goal for qualifying dwelling units financed by bonds (taxable or not) that state or local housing finance agencies issue, only if the enterprise either: guarantees the bond; or purchases it and it is not investment grade. (It appears that the GSEs can continue to get full credit for private MBS regardless of whether the securities are investment grade, as under current law.) The Director would have to create "additional requirements" for small multifamily housing projects. Small may be based on number of units or loan size, or both, but the requirement must include projects of a size typical in rural areas. For the multifamily goal, income must be measured by the income of actual or prospective tenants if data are available, and otherwise by rent levels affordable to low-income and very low-income families. A rent level is affordable for its income category if the rent level is no more than 30% of the top of that

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	conditions or enterprise financial condition, or • Meeting the goal would constrain liquidity, over-invest in market segments, or otherwise be contrary to the enterprises' statutory purposes. There is no provision for increasing the goals. Income definitions *Low income area* is a census tract or block numbering area at 80% or less of AMI in the area where the census tract or block numbering area is. For purposes of the single-family low-income areas goal, it includes families in those areas with incomes no more than 100% of AMI who live in minority census tracts. *Very low Income* The definition of very low-income is decreased from 60% of AMI to 50%. *Extremely low income* is 30% or less of AMI. Compliance determinations After year-end, the Director determines whether the enterprises meet their single-family goals, and must give its determination to each enterprise within 30 days of making it. The Director cannot make it public before giving it to the enterprise. Each enterprise has 30 days to comment on the determination. For the multifamily goal and additional requirements, the Director simply determines compliance. Special Counting Requirements The Secretary shall determine whether an enterprise receives full, partial or no credit for a transaction. In making this determination, the Secretary must consider whether "the transaction or activity is substantially equivalent to a mortgage purchase and either (A) creates a new market, or (B) adds liquidity to an existing market, provided" that the purchase is not "contrary to good lending practices" and "actually fulfills the purposes of the enterprise and is in accordance with the chartering	for a cease and desist order or civil money penalty under current law. This bill: • Makes the housing plan step optional; • Permits the Director, in case of failure to meet a goal, to prohibit new activities, freeze any pending approval of new activities, or suspend ongoing activities, pending achieving the goal; • Permits the Director to issue a cease and desist order or to assess a civil money penalty for violating any order, rule, goal, duty, or other regulation relating to the housing goals or duties; • Changes civil money penalty amounts. Currently, penalties for failure to submit a housing plan can be up to $25,000 per day, and for failure to comply with a plan or to submit annual housing reports can be up to $10,000 per day. Penalties would be: o Up to $100,000 per day for failure to meet a goal or submit or comply with a plan. o Up to $50,000 per day for failure to submit housing reports or to comply with other housing orders, rules, duties, or regulations relating to the housing goals or duties.	income category, adjusted for unit size. In establishing the multifamily goal, the Director must consider a number of factors. The factors are similar to those currently in §§ 1332 and 1334, including "ability of the enterprises to lead the industry," but the factor of "economic, housing, and demographic conditions" in current law is omitted. Increases and decreases in goals from base The Director may increase a single-family goal above the base, by regulation: • "to reflect expected changes in market performance related to" HMDA data; and • Upon considering a number of factors. The factors are similar to those currently §§ 1332 and 1334. Upon petition by an enterprise (but not others), the Director may reduce any goal, but not an additional requirement, only if: • Reduction is required by market and economic conditions or enterprise financial condition, or • Meeting the goal would constrain liquidity, over-invest in market segments, or otherwise be contrary to the enterprises' statutory purposes. Denial of a petition is judicially appealable. Income definitions *Low income area* is a census tract or block numbering area at 80% or less of AMI in the area where the census tract or block numbering area is. For purposes of the single-family low-income areas goal, it includes families in those areas with incomes no more than 100% of AMI who live in minority census tracts. *Very low Income* The definition of very low-income is decreased from 60% of AMI to 50%. *Extremely low income* is 30% or less of AMI.

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	Act…" <u>Monitoring and Enforcing the Goals</u> The Secretary would have somewhat more enforcement authority compared to current law. Currently, if HUD determines that an enterprise has failed a goal or that failure is probable, it gives written notice to the enterprise, which has an opportunity to respond in writing. HUD considers the response, and determines whether the enterprise has failed or will probably fail a goal that is feasible to meet. HUD then requires the enterprise to submit a housing plan describing how the enterprise will come into compliance. Failure to submit or comply with the plan can be the basis for a cease and desist order or civil money penalty. Failure to meet a goal, alone, cannot be the basis for a cease and desist order or civil money penalty under current law. This bill: • Makes the housing plan step optional; • Permits the Secretary to issue a cease and desist order or to assess a civil money penalty for failure to meet a goal. • Permits the Secretary, in case of failure to meet a goal, to "exercise appropriate enforcement authority available to the Secretary under this Act." • Changes civil money penalty amounts. Currently, penalties for failure to submit a housing plan can be up to $25,000 per day, and for failure to comply with a plan or to submit annual housing reports can be up to $10,000 per day. Penalties would be: o Up to $50,000 per day for failure to meet a goal or submit or comply with a plan. o Up to $20,000 per day for failure to submit housing reports or to comply with other housing orders, rules, duties, or regulations		<u>Compliance determinations</u> After year-end, the Director determines whether the enterprises meet their single-family goals, and must give its determination to each enterprise within 30 days of making it. The Director cannot make it public before giving it to the enterprise. Each enterprise has 30 days to comment on the determination. For the multifamily goal and additional requirements, the Director simply determines compliance. <u>Monitoring and Enforcing the Goals</u> (Section 139) The Director must give at least 125% credit toward the goals for mortgages that meet energy efficiency or other environmental standards and for mortgages that include a licensed childcare center. The Director may not consider any affordable housing fund grant amounts in determining compliance with the goals, but may consider purchases of loans that have otherwise received assistance from the affordable housing fund. The Director would have somewhat more enforcement authority compared to current law. Currently, if HUD determines that an enterprise has failed a goal or that failure is probable, it gives written notice to the enterprise, which has an opportunity to respond in writing. HUD considers the response, and determines whether the enterprise has failed or will probably fail a goal that is feasible to meet. HUD then requires the enterprise to submit a housing plan describing how the enterprise will come into compliance. Failure to submit or comply with the plan can be the basis for a cease and desist order or civil money penalty. Failure to meet a goal, alone, cannot be the basis for a cease and desist order or civil money penalty under current law. This bill: • Makes the housing plan step optional; • Permits the Director, in case of failure to meet a goal, to prohibit new products and new

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	relating to the housing goals or duties.		activities, or suspend products and activities, pending achieving the goal; • Permits the Director to issue a cease and desist order or to assess a civil money penalty for failure to meet a goal.
Housing Duties	Section 1335 Duty to serve underserved markets Creates a new duty for the enterprises to purchase or securitize mortgage investments and improve the distribution of investment capital available for mortgage financing for underserved markets. Requirements for duties To meet this duty, the enterprises must lead the industry in developing loan products and flexible underwriting guidelines to facilitate a secondary market: 1. For loans on manufactured homes for very low, low-, and moderate-income families 2. To preserve housing affordable to very low, low-, and moderate-income families, including projects subsidized under several federal programs (including projects subsidized under Section 8, 221(d)(3) BMIR, 236, 202, 811 and 515); 3. For loans to low and moderate income subprime borrowers including "precluding the purchase of loans with unacceptable terms and conditions including (i) mandatory arbitration provisions; (ii) single premium credit insurance financed into the mortgage; (iii) unreasonable prepayment penalties and upfront fees; (iv) introductory rates that expire in less than 10 years; and (v) any other such loans with unacceptable terms and conditions, or which are contrary to good lending practices or to sustainable homeownership.	Section 128 Duties Creates two new duties for the enterprises: • Increase the liquidity of mortgage investments; and • Improve the distribution of investment capital available for mortgage financing for underserved markets. Requirements for duties To meet these duties, the enterprises must lead the industry in developing loan products and flexible underwriting guidelines to facilitate a secondary market: 1. For loans on manufactured homes for very low, low-, and moderate-income families; 2. To preserve housing affordable to very low, low-, and moderate-income families, including projects subsidized under several federal housing programs (including projects subsidized under Section 8 housing, 236, 221(d)(3) BMIR; 202, 811 and 515) 3. For mortgages for very low, low-, and moderate-income families in rural areas and other underserved market that the Director finds lacks adequate conventional credit. Underserved markets may be defined geographically or by borrower type or market segment; and 4. For mortgages originated through State or local subsidized housing programs. Within 6 months of enactment, the Director must create a method of evaluating compliance with the	Section 138 Duties Creates a new duty for the enterprises: • Increase the liquidity of mortgage investments; and improve the distribution of investment capital available for mortgage financing for underserved markets. Requirements for duties To meet these duties, the enterprises must lead the industry in developing loan products and flexible underwriting guidelines to facilitate a secondary market: 1. For loans on manufactured homes for very low, low-, and moderate-income families (including loans secured by both real and personal property); 2. To preserve housing affordable to very low, low-, and moderate-income families, including projects subsidized under several federal programs (including projects subsidized under Section 8, 221(d)(3) BMIR, 236, 202, 811 and 515); 3. For mortgages for very low, low-, and moderate-income families in rural areas and other underserved markets that the Secretary (an undefined term) finds lacks adequate conventional credit. Underserved markets may be defined geographically or by borrower type or market segment. Within 6 months of the bill's effective date, the Director must create a method of evaluating compliance with the duties which includes rating

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	4. For loans made or purchased by community development financial institutions. 5. To assist depository institutions to meet CRA obligations. 6. For mortgages for very low, low-, and moderate-income families in rural areas and other underserved markets that the Secretary finds lacks adequate conventional credit. Underserved markets may be defined geographically or by borrower type or market segment. Within 6 months of the bill's effective date, the Secretary must create a method of evaluating compliance with the duties which includes rating the performance of each enterprise on each of the duties. Duties are enforceable just as are the goals.	duties. Each duty must be separately evaluated. Duties are enforceable just as are the goals.	the performance of each enterprise on each of the duties. Duties are enforceable just as are the goals.
Affordable Housing Fund	Section 1337 Affordable Housing Allocation <u>Contributions</u> The enterprises must set aside an amount equal to 4.2 basis points for each dollar of "total new business purchases" and transfer 65% to the Secretary of HUD to fund an affordable housing block grant program and 35% to the Secretary of the Treasury to fund "the Capital Magnet Fund." The Secretary must temporarily suspend allocations upon finding that the allocations would: • Contribute to the enterprise's financial instability; • Cause the enterprise to be undercapitalized, or • Prevent the enterprise from completing a capital restoration plan. The Secretary must issue regulations prohibiting the enterprises from "redirecting the costs…, through increased charges or fees, or decreased premiums, or in any other manner, to the originators of mortgages purchased or securitized by the enterprise."	No provision.	Section 140 The Director, in consultation with the HUD Secretary, shall "establish and manage" a fund from "amounts allocated by the enterprises". <u>Fund purposes</u> Its purposes are to provide formula grants to grantees to use to: • Increase homeownership for extremely low (30% of AMI) and very low-income (50% of AMI or in rural areas below the poverty line) families; • Increase housing investment in low income areas and areas of chronic economic stress; • Increase and preserve the supply of rental and owner- occupied housing for extremely low- and very low-income families; • Increase investment in "public infrastructure development in connection with housing assisted" by the AHF; and • "leverage investments from other sources in affordable housing and in public infrastructure development in connection with housing assisted" by the AHF.

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	Block Grant Program It's purposes are to provide formula grants to States to use to: • Increase homeownership for extremely low (30% of AMI) and very low-income (50% of AMI or in rural areas below the poverty line) families; • Increase and preserve the supply of rental housing for extremely low- and very low-income families including homeless families. Allocation of Funds For 2008, all of the available block grant program funds must be used for grants to States to facilitate modifications and refinance options for low and moderate income borrowers facing foreclosure and make available foreclosed properties to low and moderate income homebuyers. The distribution of funds shall be done by formula based upon population, delinquency rate and ratio of foreclosures to owner-occupied units. Specific requirements are included for the types of loans and types of homeowners to be assisted. Up to 20% of the funds may be used to provide loans to non-profit developers to assist homebuyers in purchasing foreclosed properties. In 2009 and subsequent years the HUD Secretary would establish a formula for distribution of the funds to States. The formula would be based on several specific factors. Grant amounts could be allocated to "a State housing finance agency, housing and community development entity, tribally designated housing entity, or other qualified instrumentality of the grantee." Each year, each grantee must establish an allocation plan for distribution of the grants and accept public comments on the plan.		Contributions The enterprises must put money into the AHF in each of 2007 through 2011 in an amount equal to "1.2 basis points for each dollar of the average total mortgage portfolio of the enterprise during the preceding year". Allocations would not be required after 2011. The Director must temporarily suspend allocations upon finding that the allocations would: • Contribute to the enterprise's financial instability; • Cause the enterprise to be undercapitalized, or • Prevent the enterprise from completing a capital restoration plan. The Director must issue regulations prohibiting the enterprises from "redirecting such costs, through increased charges or fees, or decreased premiums, or in any other manner, to the originators of mortgages purchased or securitized by the enterprise." Allocation of Funds If Congress establishes another affordable housing trust fund, the money allocated to this fund would be transferred to that fund. For 2007, the Louisiana HFA would receive 75% of available funds and the Mississippi Development Authority would receive 25%. The funds must be used for otherwise eligible activities in disaster areas declared following Hurricane Katrina and Rita. In 2008 and subsequent years the HUD Secretary would establish a formula for distribution of the funds to "the States and federally recognized Indian tribes". The formula would be based on population, families paying more than 50% of income for

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	Eligible fund activities Money can be used or committed only for assistance for: (1) Production, preservation, rehabilitation and operating costs of rental housing for extremely low- and very low-income families. (2) Production, preservation, and rehabilitation of housing for purchase of principal residences of, extremely low- and very low-income families who are first time homebuyers. The home price must meet requirements of the Cranston-Gonzalez National Affordable Housing Act and the home must meet resale restrictions of that act. Homebuyers must also complete pre-purchase counseling. No more than 10% of funds can go to homeownership activities. All allocations must be used or committed within two years of allocation or they will be recaptured and reallocated. The Secretary must have regulations governing the activities selection process which prohibit using amounts from the funds for: • Political activities; • Advocacy; • Lobbying, whether directly or through others; • Counseling services; • Travel expenses; • Preparing or providing advice on tax returns; and • Administrative, outreach, or other costs of the grantee or the funds recipients, but the regulation may permit limited funds to cover administrative costs of the grantee of carrying out the program. The regulations must also provide requirements for the awarding of grants to recipients that provide priority in funding based on the merits of an applicant's eligible activity, including: • Geographic diversity; • Ability to undertake activities timely • The extent to which rents are affordable for		housing, extremely low and very low income families, cost of development, families living in substandard housing, extremely old housing, and other factors as determined by the Secretary. Grant amounts would be allocated to "a State housing finance agency, housing and community development entity, tribally designated housing entity, or other qualified instrumentality of the grantee." Each year, each grantee must establish an allocation plan for distribution of the grants and accept public comments on the plan. Eligible fund activities Money in the AHF can be used or committed only for assistance for: (1) Production, preservation, and rehabilitation of rental housing for extremely low- and very low-income families. (2) Production, preservation, and rehabilitation of housing for purchase of principal residences of, extremely low- and very low-income families who are first time homebuyers. The home price must meet requirements of the Cranston-Gonzalez National Affordable Housing Act and the home must meet resale restrictions of that act. Homebuyers must also complete pre-purchase counseling and demonstrate that they are lawfully present in the U.S. (3) Public infrastructure development activities in connection with (1) and (2) above. Allocated funds are limited as follows: • 25% must go to REFCORP payments; • At least 10% must be used for (2) above; • No more than 12.5% can go to (3) above. All allocations must be used or committed within two years of allocation or they will be recaptured and reallocated. The Director must have regulations governing the activities selection process which prohibit using

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	extremely low income families; • The duration of affordability restrictions; • The extent other funding sources are used; and • The merits of the proposed activity. Loans that the enterprises purchase can count toward the affordable housing goals and the duty to serve underserved markets only to the extent the block grant does not fund the purchases. Eligible recipients Recipients may be for-profit or not-for-profit. Recipients must have a demonstrated experience and capacity to carry out activities as well as financial capacity and familiarity with other housing programs that could be used in conjunction with the grants. They must assure they will comply with applicable requirements. Accountability The Secretary must require each State to maintain a system to ensure that recipients use funds in accordance with applicable law and any conditions under which funds were disbursed. The Secretary must establish minimum requirements for agreements between the States and grant recipients, including reporting and auditing for the term of the grant. If a State determines that a recipient of funds has used the funds in material violation of any applicable requirement, the State must require reimbursement and the return of any unused funds. If the Secretary determines that a State failed to comply with requirements, the Secretary shall require the grantee to repay the Secretary and could terminate any assistance to the State. The State must file annual reports with the Secretary on their funding activities. The reports are public. If legislation is passed establishing an affordable housing trust fund, any amount allocated for this		amounts from the funds for: • Political activities; • Advocacy; • Lobbying, whether directly or through others; • Counseling services; • Travel expenses; • Preparing or providing advice on tax returns; and • Administrative, outreach, or other costs of the grantee or the funds recipients, but the regulation may permit use of up to 10% of grant funds to cover administrative costs of the grantee of carrying out the program. The Director must require each grantee and recipient to assure that no assistance is provided to an individual or household unless all adult members of the household provide personal identification in the form of a social security card with a photo ID card, a passport or a photo ID card issued by the Department of Homeland Security. The regulations must also provide requirements for the awarding of grants to recipients that provide priority in funding based on the merits of an applicant's eligible activity, including: • Greatest impact; • Geographic diversity; • Ability to undertake activities timely; • The extent to which rents are affordable for extremely low income families; • The duration of affordability restrictions; • The extent other funding sources are used; and • The merits of the proposed activity. Loans that the enterprises purchase can count toward the affordable housing goals only to the extent the AHF does not fund the purchases. Eligible recipients Recipients may be for-profit or not-for-profit, or faith-based organizations. Recipients must have a demonstrated ability and financial capacity to carry out the AHF activities. They must assure they will

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	program shall be transferred to that fund. Section 1339 Capital Magnet Fund A trust fund is established as a special account with the Community Development Financial Institutions Fund. The account is funded pursuant to section 1337 (35% of 4.2 bps of new business purchases). Expenditures A competitive grant program carried out by the Secretary of Treasury "to attract private capital for and increase investment in": • Development, preservation, rehabilitation and purchase of affordable housing for ELI, VLI and LI families; or • Economic development activities or community service facilities which in conjunction with housing stabilize or revitalize an area. Eligible grantees are CDFIs or nonprofits with a principal purpose of development or management of affordable housing. Eligible. Uses • Loan loss reserves • Revolving loan fund • Affordable housing fund • Fund supporting economic development activities or community service facilities • Risk-sharing loans Applications are submitted to Treasury. No one grantee can receive more than 15% of funds available in any year. Activities are to be funded in geographically diverse areas of economic distress. The grant funds are expected to leverage investment of 10 times the grant amount. Funds		comply with applicable requirements. Accountability The Director must require each grantee to maintain a system to ensure that recipients use funds in accordance with applicable law and any conditions under which funds were disbursed. The Director must establish minimum requirements for agreements between the grantees and grant recipients, including reporting and auditing for the term of the grant. If a grantee determines that a recipient of funds has used the funds in material violation of any applicable requirement, the grantee must require reimbursement. If the Director determines that a grantee failed to comply with requirements, the Director shall require the grantee to repay the Director and could terminate any assistance to the grantee. The grantees must file annual reports with the Director on their funding activities. The reports are public.

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	must be committed for use within two years or they will be recaptured. Grant funds may not be used for lobbying activities. Credit toward housing goals or the duty to serve underserved markets for purchases of mortgages that receive grant amounts is provided only to the extent the purchase is not funded by the grant. Accountability requirements for recipients and grantees are similar to those for the block grant program in Section 1337. Criteria for selection of grantees • Funds must be fairly distributed to urban, suburban and rural areas • Prioritization must be based on: - The ability to generate additional investments - Affordable housing need - Ability to utilize the funds timely		
Consistency with Mission	.		Section 141 Nothing in the housing goals, duties or affordable housing fund sections may be construed to authorize an enterprise to engage in an activity that is inconsistent with its charter.

Testimony of

Gerald M. Howard

On Behalf of:

The National Association of Home Builders

To The

United States Senate
Banking, Housing & Urban Affairs Committee

Hearing On

Reforming the Regulation of the
Government-Sponsored Enterprises

March 6, 2008

Introduction

On behalf of the almost 250,000 member firms of the National Association of Home Builders (NAHB), we appreciate the opportunity to participate in this Banking, Housing and Urban Affairs Committee hearing on legislation to overhaul the regulatory oversight of the housing Government Sponsored Enterprises (GSEs) – Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks). The GSEs are critical components of the nation's housing finance system, playing a vital role in maintaining mortgage market liquidity and stability and promoting affordable housing. It is important, therefore, that the GSEs remain financially safe and sound and focused on their Congressionally-chartered purposes. Legislation to put in place a strong and effective regulator for the GSEs is a priority for NAHB.

At the outset, NAHB would like to commend the Committee for holding this hearing at this critical moment in our nation's economic health. The GSEs offer tremendous potential to relieve the liquidity problems in the nation's mortgage market and bring immediate benefit to the overall economy. Indeed, all three GSEs have experienced sharp rises in credit demand during the 2007-2008 mortgage market turmoil. As other credit sources have dried up, the Federal Home Loan Banks have dramatically increased advances to their member institutions to help these commercial banks and thrifts fund mortgage originations for their portfolios. Fannie Mae and Freddie Mac (the Enterprises) have continued to provide liquidity for mortgage loans that fall below the conforming loan limit.

NAHB appreciates the Senate's action to include a temporary increase in Fannie Mae's and Freddie Mac's conforming loan limits in the recently enacted economic stimulus legislation. Expanding the dimensions of the conforming market is an important step toward restoring stability and liquidity in the broader mortgage markets. However, the severity of today's mortgage and housing market contagion, which is increasingly infecting the rest of the economy, requires more extensive and thorough treatment. Specifically, comprehensive GSE regulatory reform is needed to incent and oversee Fannie Mae's and Freddie Mac's mission pursuit within their expanded mortgage purchase authority.

Recent events continue to underscore the fact that the current bifurcated regulatory system for Fannie Mae and Freddie Mac, where the Department of Housing and Urban Development (HUD) oversees mission and the Office of Federal Housing Enterprise Oversight (OFHEO) regulates safety and soundness, simply is not working. It only provides a cloudy alphabet soup where major surgery is required. Until just last week, OFHEO maintained restrictive limits on Fannie Mae and Freddie Mac portfolio purchases, and OFHEO continues to impose a 30 percent capital surcharge on both companies. These restrictions have hamstrung the Enterprises at a time when their capacity was and is critically needed. NAHB also believes Fannie Mae and Freddie Mac have not accomplished as much as they are capable of, even within these constraints.

In addition, both companies are imposing higher fees that will raise mortgage borrowing costs for individuals and families who are most in need of the benefits that GSEs can inure. This paradox is reflective of poor or nonexistent coordination between OFHEO and HUD as well as weak mission oversight from HUD, which should be requiring more, not less, in the present dire mortgage market circumstances. Reform of this flawed framework is long overdue and urgently needed.

To that end, NAHB appreciates your commitment to enacting legislation to improve and bolster the regulatory framework for the housing GSEs. NAHB supports the establishment of a regulatory structure that can ensure that the housing GSEs operate in a safe and sound manner while effectively and assertively pursuing their housing mission. NAHB believes that the housing GSEs are essential components of the nation's housing finance system and our foremost interest is that change in the regulatory regime should not, in any way, diminish the benefits that these entities provide to home buyers and renters.

Although there is a myriad array of factors and ingredients to consider in the reform debate, NAHB believes the optimal approach to GSE reform incorporates four guiding principles: First, the advantages available to the GSEs through the public/private partnership of the housing finance system should be retained. Second, reform measures should reinforce the obligation of the GSEs to channel those advantages to the nation's home buyers and renters. Third, the most efficient and demonstrable method of accomplishing this objective is through enhanced safety and soundness regulation and stronger GSE affordable housing requirements. Fourth, there must be a balance between safety and soundness oversight and mission regulation so as not to impede the GSEs' housing mission.

NAHB believes that H.R. 1427, the "Federal Housing Finance Reform Act of 2007," (the House Bill) which passed the House last May, makes significant progress in meeting these objectives.

NAHB's views on the current GSE regulatory reform discussions can be effectively distilled down to six key components: (1) regulatory structure; (2) program oversight; (3) conforming loan limits; (4) affordable housing requirements; (5) capital requirements; and, (6) portfolio limits. The remainder of NAHB's statement addresses these components.

Regulatory Structure

An overriding issue in the GSE regulatory reform discussion is achieving the appropriate balance between safety and soundness and mission oversight in the structure and governance regime of the regulator. It is a priority for NAHB that Congress establishes a strong system for regulating the safety and soundness of the GSEs without displacing the focus on the housing mission of the GSEs.

As mentioned, the Department of Housing and Urban Development (HUD) currently oversees the mission of Fannie Mae and Freddie Mac, including approving new programs and establishing and enforcing affordable housing goals (annual mortgage purchase targets that Fannie Mae and Freddie Mac must reach). The Office of Federal Housing Enterprise Oversight (OFHEO), an independent agency within HUD, oversees the financial safety and soundness of Fannie Mae and Freddie Mac. For the FHLBanks, another independent agency, the Federal Housing Finance Board (FHFB) regulates both mission and financial safety and soundness.

Several questions have been raised as to how to better configure this oversight system. One area of inquiry with bearing on the mission/safety and soundness balance is the location and independence of the GSE regulator. NAHB believes the regulator should be an independent entity outside the control of any cabinet department or regulatory agency. The agency must have independence or autonomy in pursuing its regulatory duties.

Perhaps the greatest concern for NAHB in this area is the governance of a new GSE regulatory agency. Ideally, NAHB believes the new regulator should be governed by a board modeled on the Federal Deposit Insurance Corporation (FDIC), where the board seats are divided between government representatives and private individuals with appropriate regulatory expertise. In the case of the GSE regulator, the board would be made up of the Secretaries of HUD and Treasury and three private individuals, one of whom would serve as the board chair. The goal is to infuse additional expertise in and concern for housing and housing finance through the appointment of individuals with such credentials.

As an additional counterbalance between mission and safety and soundness regulatory objectives, NAHB supports the creation of deputy director positions to oversee the various regulatory elements. In this regard, NAHB supports separate regulatory divisions for oversight of safety and soundness and for regulation of housing mission. NAHB encourages the Committee to ensure that the FHLBank mission and safety and soundness oversight reflects the unique mission, operating structure and charters of the FHLBank System.

Program Approval

An important part of the mission oversight responsibilities of a GSE regulator is the review of activities to ensure conformance with a GSE's charter and public purpose. In addition to providing liquidity and lowering borrowing costs in the housing finance system, the housing-related GSEs support innovation in mortgage products and programs as well as technological improvements that address housing needs. In considering a new GSE regulatory regime, a key challenge involves developing a program review and approval process that is sufficiently rigorous to ensure charter compliance, support for achievement of affordable housing goals, and safety and soundness while facilitating the GSEs' ability to continue to engage in program, product and technological innovation to address market needs in a timely manner.

NAHB supports a program approval process for the Enterprises that ensures they are operating within their charters and undertaking activities in a safe and sound manner. The program approval process should also accommodate innovation and prompt responses to market needs. To accomplish that, program oversight should focus on broad categories of programs and should not involve micromanagement of individual activities within an approved program area.

Prior approval should only be required for new "programs" that represent broad areas of "products" and/or "activities" that are significantly different from those previously undertaken. New activities under previously approved programs should not require prior approval. However, the regulator should be notified in advance before a new activity under an approved program is undertaken. Review of previously approved programs and activities should occur only as a part of safety and soundness supervision. The regulator should be granted a reasonable, but limited period of time for review of new programs submitted for prior approval.

The key criteria in the program approval process should be whether a program is permitted under a GSE's charter and needed to facilitate achievement of mission, including affordable housing goals. Safety and soundness of new activities should be a factor only if it is determined that the nature or scope of the activity cannot be adequately addressed through risk-based capital requirements and that the proposed activity poses a significant threat to the financial health of the GSE.

Conforming Loan Limits

By their charters, Fannie Mae and Freddie Mac are restricted to purchasing mortgages with loan amounts at or below their statutory loan purchase limit, referred to as the "conforming" loan limit. The conforming loan limit is increased annually on the basis of the annual percent change in the average home price index computed by the Federal Housing Finance Board (FHFB). The loan limit ceiling is 50 percent higher in Alaska, Hawaii, Guam and the U.S. Virgin Islands to account for higher housing costs in these areas.

NAHB supports the current statutory procedure for adjusting the conforming loan limit, which only allows for percentage increases in the limit that correspond to increases in the underlying index. NAHB opposes measures that would permit the conforming loan limit to decrease in proportion to a year-to-year decline in the statutory home price index. A decrease in the conforming loan limit would disrupt mortgage markets and, considering the length of the mortgage process, would be a source of apprehension among borrowers. The conforming loan limit has been held at the previous year's level in those years when the index has declined and these decreases have been netted out of increases in subsequent years. This system has worked well and has provided stability in times when the home price index has increased, as well as when it has decreased.

The current statutory system, however, inhibits origination of conforming loans in states where typical home prices exceed the conforming loan limit. Thus, borrowers in these states cannot benefit from lower rates on conforming loans. The interest rate disadvantage faced by mortgage borrowers in higher-cost states has increased tremendously during the mortgage market turmoil of the past seven months. To rectify this situation, NAHB supports the establishment of a high-cost area exception that would allow the conforming loan limit in high cost areas to reflect the higher home price distribution, subject to an overall cap.

As mentioned, NAHB appreciates the action of the Senate to include a temporary increase in Fannie Mae's and Freddie Mac's conforming loan limits in the recently enacted economic stimulus legislation. The Stimulus Act raises the loan amount the GSEs can purchase up to the greater of the current national conforming loan limit of $417,000 or 125% of the local median home price. The limit is capped at $729,750 and is available for loans originated between July 1, 2007 and December 31, 2008. This provision is a step toward increasing the availability of mortgage money in higher-cost areas and resolving some of the serious dislocations that have occurred in specific market segments. However, NAHB believes comprehensive reform of GSE regulation is a prerequisite for effective and sufficient mission accomplishment by Fannie Mae and Freddie Mac through use of the expanded loan caps. Without coordinated and balanced oversight of mission and safety and soundness of Fannie Mae and Freddie Mac, the results of the loan limit increase will continue to be retarded by inappropriate regulatory impediments and insufficient mission motivation on the part of the Enterprises. This fact lies at the heart of NAHB's belief in the importance of prompt completion of work on a full GSE reform bill. The legislation should extend the conforming limit increase to two years to allow sufficient time for implementation and results.

NAHB has reservations about restricting activity under increased conforming loan limits to mortgages that are securitized and sold. Such a limitation unnecessarily restricts Fannie Mae's and Freddie Mac's operational flexibility and could undercut the benefits of the limit increase. Ultimately, borrowers are unaware of the workings of the secondary market for mortgage loans. These borrowers should not be affected differently if a loan is targeted to be held in a GSE's portfolio or if a loan will be used as collateral for a mortgage-related security.

Affordable Housing Requirements

NAHB believes the housing GSEs can and should do more to accomplish their affordable housing mission. The affordable housing requirements for Fannie Mae, Freddie Mac and the FHLBanks should be strengthened to ensure a more effective and targeted transfer of GSE benefits to the housing marketplace. Such changes, however, should not be undertaken in a manner that impairs the GSEs' ability to achieve their mission of providing liquidity to the mortgage markets.

Presently, Fannie Mae and Freddie Mac are required by law to meet annual housing goals established by the Department of Housing and Urban Development (HUD). The housing goals track Fannie Mae's and Freddie Mac's purchases of mortgages for low- and moderate-income people (the low/mod goal); loans in underserved geographically targeted areas (the underserved areas goal); and, mortgages for very-low income people and neighborhoods (the special affordable goal). Each of the 12 FHLBanks is required by law to contribute at least 10 percent of its annual net earnings to an Affordable Housing Program (AHP). The AHP subsidizes the cost of housing for very-low-income and low- or moderate-income owner-occupied and rental housing. The subsidy may be in the form of a grant ("direct subsidy") or a below-market interest rate on an advance (loan) from the FHLBank to a member lender.

Affordable Housing Goals for Fannie Mae and Freddie Mac

Housing goals levels should continue to be established through regulations that incorporate general statutory criteria. NAHB recommends that the legislation should specify that the goals levels should be calibrated to the midpoint of the regulator's market estimates. NAHB believes setting the goals levels at the midpoint of the market estimates minimizes the risk that the goals are unfeasible simply because they do not reflect current market conditions. In this scenario, NAHB believes that the GSEs would be well-positioned to make immediate enhancements to their affordable housing initiatives.

NAHB believes that the current statutory income definitions in the affordable housing goals are too generous. Each income level should be lowered to focus Fannie Mae and Freddie Mac more directly on lower-income populations. NAHB believes that more narrowly tailored income definitions will result in more concentrated efforts by the GSEs and expand homeownership and economic opportunities to people and areas most in need.

Further, we believe the housing goals provisions should specify in legislation that single family refinancing activity should be eliminated from the market size estimates and goals calculations. The volatility of refinancing activity has a significant impact on market size estimates and on the ability of the enterprises to meet the housing goals without disrupting the secondary market. Refinancing volume is driven by interest rate fluctuations, not by enterprise outreach activities. Removing single family refinance transactions from the market estimates and goals calculations would eliminate these negative effects and would focus Fannie Mae's and Freddie Mac's activities directly on supporting affordable housing home purchase transactions.

In the multifamily area, NAHB supports the expansion of the current statutory definition to include dwelling units assisted by the low-income housing tax credit as well as credit for units financed by Housing Finance Agency (HFA) bonds. These changes address serious shortcomings in the present housing goal statute which does not permit such investments to be counted as goals-qualifying activities. These instruments finance much of the newly built multifamily rental housing that is affordable to households with low- and moderate-incomes. Thus, the Enterprises should get goals credit for purchases of mortgages on properties that were financed with these instruments.

Further, NAHB strongly supports additional requirements for smaller projects, particularly for projects of 5 to 50 units. These units are key sources of affordable housing for large numbers of low- and moderate-income households, first-time homebuyers and minorities. NAHB has long supported improved financing mechanisms for small projects. Financing for small projects often is difficult to obtain and relatively expensive compared to financing costs for larger projects. Small project loans are generally made by portfolio lenders who hold the loans in portfolio. Given the importance of small projects in providing affordable housing, HUD provided bonus points for the GSEs' purchase of such loans in its 2001-2003 Housing Goals rule. The bonus points system worked as the GSEs doubled their purchases of small multifamily loans during this time. Unfortunately, HUD eliminated the bonus point system in the current housing goals rule and the GSEs' focus on smaller properties has waned. Establishing small projects requirements will re-focus the GSEs on this important source of affordable housing.

Duty to Serve Underserved Markets

NAHB supports establishing a duty for the Enterprises to serve underserved markets. Such a provision would direct the Enterprises to develop products and engage in activities to reach the most difficult underserved housing markets, including manufactured housing, affordable housing preservation, rural and other underserved markets. NAHB notes that such a provision would encourage the Enterprises to expand beyond better-served markets, similar to the bonus point system under HUD's 2001-2003 housing goals rule. NAHB believes that an underserved markets requirement would work in a similar way as a means to direct GSE purchases toward specific market segments. NAHB recommends that the list of underserved markets should include very low-, low- and moderate-income first-time and minority home buyers.

Affordable Housing Fund for Fannie Mae and Freddie Mac

NAHB strongly supports the creation of an affordable housing fund established through annual contributions by Fannie Mae and Freddie Mac and modeled on the statutorily prescribed Affordable Housing Program (AHP) of the Federal Home Loan Bank System. Such a fund would, in combination with more challenging housing goals standards, raise the bar for Fannie Mae's and Freddie Mac's mission activities to more effectively channel benefits of their GSE charters to serve housing needs that are currently unmet. The goal of the fund is to support activities that cannot be undertaken as part of Fannie Mae's and Freddie Mac's traditional lending and investment business.

The focus of this fund would be to increase affordable homeownership and rental opportunities for very-low and extremely-low income households, increase and preserve the supply of housing for such households and support infrastructure development in connection with housing. In addition, the fund should seek to leverage investments from other sources to support development financed by fund grants.

It is important to provide for a fair allocation of the funds. Allocation of grants should be based on the qualities of proposed housing rather than the characteristics of the sponsor as a basis for awarding grants. In addition, there should be standards for applicants to demonstrate both the experience and capacity to successfully and efficiently employ funds. This would ensure that funds are put to the most effective use.

Revisions to the FHLBank Affordable Housing Program

NAHB recommends revising the statute for the Federal Home Loan Bank Affordable Housing Program (AHP) in order to remove the current statutory priority for allocations to nonprofit sponsors in the competitive selection criteria. This part of the law has impeded participation by NAHB's members in the AHP. The exclusion of capable and experienced for-profit housing producers needlessly works against the goal of providing housing most efficiently in areas where it is needed most.

Capital Requirements

Capital requirements for financial institutions establish the level of reserves that these organizations must maintain to protect against their exposure to various types of risks, including credit risk of loans and guarantees, interest rate risk of the balance sheet, and management and other operational risk. Capital requirements also limit the degree to which financial institutions can leverage their sources of funds in pursuing business opportunities. Generally, financial institutions are held to two separate capital standards: a risk-based requirement that is driven by the composition of an institution's loan and investment portfolio and other operating characteristics, and a minimum capital requirement that ensures some capital cushion regardless of the outcome of the risk-based standard. This is the case for Fannie Mae, Freddie Mac and the FHLBanks, where risk-based and minimum capital requirements are established by law.

The Committee should be mindful that changes in the GSEs' capital requirements have a direct impact on the availability and cost of mortgages in the housing finance system. Higher capital requirements limit GSE activity, reduce the range of GSE products and programs (impairing the ability to serve low- and moderate-income borrowers) and increase the cost of mortgage borrowing. Capital requirements that exceed those dictated by the risk of GSE activities and operations unnecessarily reduce the flow of capital to the housing finance system and add unnecessarily to the cost of those funds. The result would be a significant setback to current efforts to expand affordable homeownership and rental housing opportunities.

There is fairly widespread agreement that the new GSE regulator must have much greater authority to adjust capital requirements than the current regulators possess. Concepts and systems for determining risk-based capital requirements have evolved significantly since statutory requirements for Fannie Mae and Freddie Mac were established and it is argued that the current specificity of the statute in this area makes it difficult, if not impossible, for the regulator to adopt and maintain a state-of-the-art risk-based capital framework.

NAHB agrees that the GSE regulator should have full authority to establish and adjust the risk-based capital system as the state of the art evolves. NAHB supports the removal of the current statutory criteria governing risk-based capital requirements for Fannie Mae and Freddie Mac to allow the new regulator full freedom to establish and adjust such standards through regulation. Comparable authority should be granted to the regulator with regard to the risk-based capital requirements of the FHLBanks.

With regard to minimum capital, the most debated policy questions appear to be whether the minimum capital requirements should remain unchanged in statute and what degree of authority should be granted the new regulator to adjust the minimum requirements. Minimum capital requirements are intended to function as a backstop to risk-based systems and NAHB believes the minimum standard for the GSEs should continue to serve that purpose. NAHB supports maintaining the current statutory minimum capital requirements. Further, NAHB believes that the GSE capital requirements should address only risks that are internal to the GSEs, not external risks such as systemic risk in the financial sector. To that end, we support authority for the GSE regulator to adjust minimum capital requirements, as long as such adjustments are justified by changes in actual or perceived risk to a GSE and do not unnecessarily impair the GSEs' ability to achieve their mission. NAHB believes that criteria for temporary increases in minimum capital should be focused on the safety and soundness of the GSEs, but should also address concerns about the possible impact of capital provisions on mission by providing for a process where temporary capital increases would be regularly reviewed and returned to the statutory level once the "triggering" issue or issues are resolved.

NAHB supports the fundamental principle that adjustments to minimum capital requirements must be temporary and that the regulator should deal with longer-term risks through the risk-based system. In addition, all changes to GSE capital – risk-based and minimum – should be undertaken through proposed regulation that provides public notice and comment, except in emergency situations, where increases could be instituted and then reevaluated in a subsequent review and comment protocol.

Portfolio Limits

Proposals to arbitrarily limit or reduce the portfolios of Fannie Mae and Freddie Mac are misguided and would have significant adverse effects on the housing finance system. Both Fannie Mae and Freddie Mac hold sizeable portfolios of mortgages and mortgage-backed securities, which play an important role in stabilizing the supply and reducing the cost of housing credit.

First, the portfolios support the provision of mortgage credit through instruments, such as multifamily mortgages and various homeownership loans designed for lower-income borrowers that are not attractive to secondary market investors and, therefore, cannot be packaged and sold in mortgage-backed securities. Such products are expanding as more focus and requirements are placed on the GSEs to address the housing finance needs of more difficult to reach segments of the population.

Second, the GSE portfolios have served as an important shock absorber for housing borrowers in times of economic crisis. This is evidenced by the relative stability in mortgage availability and interest rates as other sectors of the financial markets were experiencing severe volatility in credit availability and cost during the 1998 international debt crisis and again following the 9/11 terrorist attacks in 2001. More recently, the portfolios of Fannie Mae and Freddie Mac allowed them to play a major role in efforts to rebuild housing and other pressing housing finance needs in the Gulf Coast areas that suffered hurricane devastation in 2005. Fannie Mae and Freddie Mac stepped up their portfolio purchases to stabilize the mortgage markets in all of these periods and mortgage credit remained available at affordable rates.

Third, the added demand from Fannie Mae's and Freddie Mac's portfolio purchases helps to lower yields on mortgage-backed securities which flow through to lower rates on the underlying mortgages. Some have argued that removing Fannie Mae and Freddie Mac as buyers in this market would have no impact on mortgage borrowing costs. NAHB believes that such a position ignores the basic economic principle of supply and demand. Cutting GSE portfolio holdings by more than a trillion dollars, as some have proposed, would certainly have a major adverse impact on mortgage rates, even if the reduction were phased in over a number of years.

Finally, GSE portfolio operations have facilitated an expansion of investors in the U.S. housing markets. Foreign investors have supplied increasing amounts of capital for residential mortgages in this country through purchases of GSE debt and currently account for a significant portion of such holdings. Some foreign investors are reluctant to invest in mortgage-backed securities, primarily due to unfamiliarity with fixed-rate, long-term mortgage collateral and concern over prepayment risk on such loans. The GSEs have successfully negotiated this obstacle by purchasing and holding mortgage-backed securities through funding provided by sales of their debt to foreign investors. GSE portfolio restrictions, therefore, would constitute a major setback to successful efforts to broaden the sources of capital for the U.S. housing markets.

NAHB recognizes that Fannie Mae and Freddie Mac also are able to generate profits through their portfolio operations by virtue of the spread between their advantaged borrowing costs and market yields on mortgage-backed securities. NAHB shares the concern that has been expressed that such profits have been directed too extensively to GSE shareholders and executives. However, NAHB believes the best way to address this is not through restricting and shrinking GSE portfolios. Such actions would undercut the GSEs' ability to continue the pursuit of the valuable results outlined above. Instead, NAHB believes that the recommendations contained elsewhere in this statement to toughen GSE affordable housing requirements, including mandating annual Fannie Mae and Freddie Mac contributions to an Affordable Housing Fund, would succeed in more effectively directing GSEs' portfolio profits to mission purposes.

With regard to safety and soundness, the new regulator should hold each GSE accountable to have the strategies, systems, personnel and capital that are adequate to fully mitigate any risk to the Enterprises associated with the holding of mortgages and mortgage-backed securities as well as other portfolio investments. This would include the establishment of risk-based capital requirements to provide appropriate capital coverage for all portfolio-related activities. In addition, review of portfolio functions and operations should be an integral part of the regular safety and soundness examinations conducted by the regulator. Specific limits on the GSEs' portfolios therefore are overreaching and unnecessary in addressing their safety and soundness.

Conclusion

NAHB appreciates the opportunity to submit our views on the regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks, the housing GSEs. It goes without saying that the GSEs have been and continue to be critical components of the nation's housing finance system, a system without equal anywhere in the world and one that contributes so much to the national economy. For this reason, NAHB fully supports the Senate Banking, Housing and Urban Affairs Committee's consideration of regulatory reforms to these critical entities, and urges the committee to act promptly to advance bi-partisan legislation.

NAHB is pleased to be part of the process to improve a clearly lacking oversight system, establish a strong and effective regulator and ensure that the GSEs continue to expand housing opportunities for American families. We believe that this process can be a success without undercutting the GSEs' housing mission if the following areas are addressed: one, balance housing with safety and soundness concerns; two, maintain the GSEs' flexibility to respond promptly, within their charters, to market needs; three, extend the increase of conforming loan limits in high cost areas; four, focus and enhance GSE benefits to expand affordable housing opportunities; five, employ capital as a precise instrument of risk management; and, six, preserve GSE portfolios as tools for achieving liquidity and affordable housing mission.

NAHB looks forward to working with the Congress to use these principles to achieve our mutual goals as the legislative process moves forward.

Testimony of Nancy O. Andrews
President and CEO of the Low Income Investment Fund
presented to the Committee on Banking, Housing and Urban Affairs
United States Senate
"Reforming the Regulation of the Government Sponsored Enterprises"
March 6, 2008

Thank you Chairman Dodd and Ranking Member Shelby for including the perspective of community development lenders in this important hearing. My name is Nancy Andrews, and I am the Chief Executive Officer of the Low Income Investment Fund (LIIF). We are a national community development financial institution (CDFI), whose mission is poverty alleviation.

I will focus my comments on how Fannie Mae and Freddie Mac can provide even greater support to affordable housing for those most in need. Specifically, I will discuss the need for an affordable housing fund, which would make a big difference in the ability to serve both the CDFI industry and the GSEs' collective mission to serve a greater number of low-income people with affordable housing.

I will make three key points in my testimony today:

- First, having strong and stable GSEs focused squarely on the mission of affordable housing is essential.
- Second, deeply targeted affordable housing must be part of any GSE reform effort and the creation of an affordable housing fund will accomplish this.
- And finally, the formation of the Capital Magnet Fund proposed by Senator Reed in his "Government Sponsored Enterprise Mission Improvement Act," Senate bill 2391, would have, by far, the greatest impact and deepest reach for serving low-income people and communities.

Background on the Low Income Investment Fund & CDFIs

Over its 23-year history, LIIF has provided approximately $700 million in financing for community projects in 26 states. LIIF's capital is part of the puzzle in producing affordable housing – and the need is great. The National Low Income Housing Coalition, on whose Board I serve, estimates that there is a deficit of over five million units affordable to very low-income populations. The Coalition's "Out of Reach" publication also establishes that there is "***no county*** in the U.S. where the average rental unit is affordable to someone earning the minimum wage."

LIIF responds to this problem by providing capital when banks cannot or will not lend, and you can measure our impact through our track record. We have financed:

- 54,000 homes for families and kids;
- 47,000 spaces of safe, high-quality childcare;
- 40,000 spaces in schools where children can get a good education; and,
- Over 2.5 million square feet of commercial space.

About three-fourths of our projects serve very low-income families. This is truly deep-reach lending. Yet in 20+ years, LIIF has suffered capital losses of only 0.07 percent – that's less than a tenth of one percent. This prudent and sound deployment of private capital has leveraged additional investments of nearly $5 billion. This story is primarily a story about leverage, and that's one of the main points of my testimony.

My organization's track record is not unique. Across the country, there are hundreds of CDFIs. In fact, there are CDFIs in every state. Collectively, we provided $4.75 billion in financing in 2006 alone.[1] This financing served low-income families and neighborhoods with housing, jobs, schools, health care centers, and economic growth projects.

[1] CDFI Data Project, "The CDFI Data Project," (2008): http://www.opportunityfinance.net/industry/industry_sub2.aspx?id=236. There were 505 CDFIs surveyed.

I've included examples of CDFI work in several states at the end of this document. Just one example of my organization's work is a $10 million construction loan to preserve the Elva McZeal Apartments in Brooklyn, New York. This is a 142-unit project that provides Section 8 subsidized housing. The apartments will be renovated and converted to home ownership for the tenants, all of whom are very-low income and primarily single, female-headed households. The tenants will be provided affordable fixed-rate mortgages with which to purchase their homes. LIIF estimates that the economic benefits to residents are over $50 million over the lifetime of the project.

CDFIs finance small businesses, homeownership, affordable rental housing, childcare facilities, and charter schools. There are more than 1,000 CDFIs in the United States. Despite this small number, CDFIs are leading the financial services industry in developing innovative and socially responsible strategies to deliver credit to working poor and low-income families and communities. Over the past 30 years, CDFIs have provided more than $23 billion in financing that would not otherwise have happened in markets that conventional finance would not otherwise reach. We are able to lend successfully in these markets in part because CDFIs build their borrowers' capacity by combining financing with technical assistance such as homeownership counseling, entrepreneurial training, and financial literacy education.

America Faces a Critical Shortage of Affordable Homes for Very-Low Income People

Today, very low-income Americans face a critical shortage of affordable, decent homes. And the problem is worsening dramatically. Harvard University's "State of the Nation's Housing 2006" reports that in the 10 years between 1993 and 2003, America lost 1.2 million units of housing affordable to poor families. The federal government directly supports only about five million households through all of its direct housing expenditures, such as public housing, Section 8, and other forms of assistance. This number has not changed significantly in more than a decade. Meanwhile, median housing costs have climbed relentlessly through this period while thousands of homes that received project-based assistance through earlier programs like Section 236 have been lost to very low-income people because of sale, conversion to higher income uses, or demolition.

A recent report based on an analysis of the 2005 "American Community Survey" and published by the National Low Income Housing Coalition summarized the problem succinctly:

Between 2001 and 2005:

- The number of extremely low-income renters increased at a faster rate than any other income and tenure group;
- The only significant population shift from renting to owning was among upper- and middle-income households;
- The number of households facing a severe housing cost burden increased 23 percent nationwide; and
- The increase in severe housing cost burden was primarily due to the addition of more than one million severely cost burdened, extremely low-income renters.

As a result, in 2005:

- Only 38 affordable and available units existed for every 100 extremely low-income renter households nationwide;
- About 3.4 million households lived in crowded homes, and approximately 850,000 were without complete bath or kitchen facilities; and

- Low-income Americans faced unsustainable housing cost burdens in all 50 states and the District of Columbia.[2]

Healthy GSEs are Essential for Affordable Housing Mission

I believe a strong and sound GSE system is essential to a healthy housing market and to the GSEs' affordable housing missions.

We support strengthening Fannie and Freddie's Affordable Housing Goals. Fannie Mae and Freddie Mac should have reporting guidelines. Specifically, the low-income housing goals should be tightened. We also endorse multi-family and refinance goals as proposed by Senator Reed.

GSEs must lead the industry in bringing solutions to underserved markets and have a duty to serve these markets, recognizing that a reasonable rate of economic return may be less than the return earned on other activities. These markets include manufactured housing, affordable housing preservation, subprime borrowers (disallows loans with predatory lending characteristics, CDFIs, rural and other underserved markets, and any other markets the Secretary designates. The GSEs must report annually to Congress on their progress to ensure this is accomplished.

There is, however, a part of the housing production spectrum the GSEs have never been able to reach effectively: affordable rental and ownership housing for very low- and extremely-low income families. CDFIs lend to these deep-reach projects every day in all 50 states, and have done so for more than three decades with very few losses. We know how to safely and soundly introduce these opportunities to the capital markets and our underwriting rivals that of standard banks. We believe that sound underwriting combined with financial education is key. But we could do this at far greater scale in partnership with the GSEs.

[2] Danilo Pelletiere, PhD and Keith E. Wardrip, National Low Income Housing Coalition, Executive Summary, "Housing at the Half: A Mid-Decade Progress Report from the 2005 American Community Survey," (February 2008): http://www.nlihc.org.

Additionally, the GSEs must take a leadership role in tackling the enormous devastation created by the subprime meltdown and foreclosures that are affecting low- and moderate-income communities across the country.

Finally, there must be certain penalties and remedies for failure to comply by the GSEs.

An Affordable Housing Fund is Vital to the GSE Mission

It is for this reason that the CDFI industry strongly supports Senator Reed's proposal to create an Affordable Housing Fund requiring Fannie Mae and Freddie Mac to set aside 4.2 basis points on each dollar of new business purchases.

Sixty-five percent of the set-aside from Senator Reed's bill would go to an Affordable Housing Block Grant Program administered by the Secretary of Housing and Urban Development. In the first year after enactment, this fund would be allocated to the states by formula to help address the current subprime mortgage crisis. Funds should be distributed to the states to:

- Facilitate loan modification and refinance options for low- and moderate-income borrowers facing foreclosure; and
- Expeditiously made available to low- and moderate-income homebuyers, properties that have been foreclosed upon.

After 2008, the funding should be distributed to the states for the development, construction, and preservation of housing for very low- and extremely low-income families. The GSEs should not be able to count contributions to the Affordable Housing Block Grant Program toward their housing goals and duty to serve underserved markets unless the GSEs purchase mortgages created from the grants with capital outside of the annual 4.2 basis points on new business. And there should be tracking measures for the grants to allow for complete transparency of the projects, including financial and project reporting, record retention, audits, and any other requirements needed.

Prioritization in funding recipients should go to where there is the greatest need based on geographic diversity, ability to obligate amounts and undertake activities in a timely manner, the extent to which rental projects are affordable, especially for extremely low-income families, the time period for which rents remain affordable, the extent the application makes use of other funding sources, and the merits of the applicant's proposed eligible activity.

Senator Reed's bill does not include the Federal Home Loan Banks. This is because they already have their own Affordable Housing Program and are contributing at least 10 percent of their previous year's net earnings for this, subject to a minimum annual combined contribution by the Banks of $100 million. However, I encourage you to consider a similar affordable housing goal structure as Fannie Mae and Freddie Mac to ensure that the FHLBs are fulfilling their missions.

The FHLB Affordable Housing Program subsidizes the cost of affordable owner-occupied and rental housing targeted to individuals and families with incomes at or below 80 percent of the median income for the area. Since the program's inception, the Banks have awarded more than $2 billion in grants through its members. This, however, does not reach the nation's neediest citizens. The area median income should be tightened as Senator Reed suggests for the other affordable housing programs.

Between 1990 and 2004, nearly 430,000 housing units have been subsidized through these grants. In 2004, $229 million was made available by the Banks to subsidize 39,802 units of owner-occupied or rental housing. The success of the AHP is an example that deepening Fannie and Freddie's responsibilities towards affordable housing must be a part of any type of GSE reform.

Even with this success, the FHLB System does not go far enough to reach those most in need. Today, there is no current federal housing program that increases the supply of housing affordable to those with the greatest need in this country.

GSE reform legislation should establish a community economic development fund analogous to its Affordable Housing Program (AHP) by modifying the FHLBs' RefCorp payment obligation. For transparency, the FHLBs should also be required to share information among the Banks to allow each Bank, its members, and the public to evaluate the financial condition of the other Federal Home Loan Banks individually and the Federal Home Loan Bank System.

We strongly encourage you to take a close look at the FHLB System and make reforms that encourage reaching our lowest-income communities with affordable housing, economic, and community development.

Capital Magnet Fund will have the Greatest Impact on Affordable Housing

Within the new Affordable Housing Fund, Senator Reed is proposing a Capital Magnet Fund, capitalized by the other 35 percent of the set-aside. The Capital Magnet Fund would be administered by the Secretary of the Treasury and would be a perfect complement to the Affordable Housing Block Grant Program. But, it would have a separate purpose, use, and structure. This purpose is to leverage GSE dollars with private dollars to expand much-needed housing and economic development for our extremely low- and very low-income families and communities.

Uses for the Capital Magnet Fund include development, preservation, rehabilitation, or purchase of affordable housing for primarily extremely low-, very low-, and low-income families, and community or economic development activities in support or to sustain an affordable housing project. Eligible activities include loan loss reserves, revolving loan funds, equity capital for affordable housing funds, equity capital for community or economic development funds, and risk sharing loans.

With the increasing sophistication and scale of the community development industry, we believe high-performing organizations could use grants from the Capital Magnet Fund to attract substantial investment from the private sector, producing greater results with a given level of resources. The Capital Magnet Fund would not use the GSE contributions to subsidize individual projects; instead, it would enable recipients to create pools of capital to support multiple projects.

The Capital Magnet Fund would be used by CDFIs and other mission-driven developers to do what they do best: leverage private investment into poor communities. According to the Treasury Department, CDFIs leverage $19 in private investment for each federal dollar invested.[3] The proposed Capital Magnet Fund takes resources that the GSEs earn, partly on the strength of their special relationship with the government, and puts them to work more effectively and more directly than either Fannie or Freddie have demonstrated they are able to do independently.

So, for example, a $10 million investment from the Capital Magnet Fund into LIIF would mean we could invest $200 million in affordable housing projects. CDFIs across the country can do the same thing as shown by the examples included at the end of this document.

This approach stretches the enterprises' helping hand to communities and neighborhood projects that are currently out of reach in an innovative and high leverage manner. This strategy is smart subsidy—it not only offers high impact for resources, but simultaneously delivers much needed liquidity to benefit the people and markets most in need. This is good for the enterprises, good for the taxpayer, and good for low-income and underserved communities. Creating a Capital Magnet Fund to garner more aggressive pricing and underwriting of the enterprises' core business products, including mortgage lending, as well as other private capital, will facilitate the financing of affordable housing and community development by nonprofits and other mission-driven developers.

Since the Capital Magnet Fund's purpose is to leverage private sources of capital with an initial federal investment, it makes sense that its administration is with a recognized federal

[3] CDFI Fund figures available at http://www.cdfifund.gov/impact_we_make/overview.asp.

agency that serves this purpose. The U.S. Treasury Department's Community Development Financial Institutions Fund (CDFI Fund) was created for promoting economic revitalization and community development.

Since its creation, the CDFI Fund's $842 million in equity investments has generated an additional $2.6 billion in non-federal financing in emerging domestic markets. CDFIs are using scarce federal resources to leverage capital and community impact that is many times greater than the dollars received. According to the U.S. Department of Treasury, CDFIs leverage $19 in non-federal funds for each federal dollar invested.[4] In addition, the CDFI Fund has allocated $16 billion in New Markets Tax Credit investment authority. This established and successful government agency is well equipped to administer the Capital Magnet Fund.

Conclusion

In conclusion, the GSEs can and must play a stronger role in supporting housing affordable to very low-income families. They also must be financially sound, and this should come first. They have done much, but they can do more. Working with the GSEs through the Capital Magnet Fund, CDFIs can draw private investment into projects they would not otherwise be able to support; we can do this safely and soundly; and we can multiply the impact of the federal dollar many times over. The combination of strengthened goals, the Affordable Housing Fund, which includes the Affordable Housing Block Grant Program and the Capital Magnet Fund, will create a formula of success that will allow the GSEs' to reach deeper than ever before to serve our nation's very low-income families.

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[4] "The Differenced the CDFI Fund Makes," CDFI Fund website (2008): http://www.cdfifund.gov/impact_we_make/overview.asp.

There is a part of the housing production spectrum the GSEs are not yet reaching. CDFIs lend to these deep-reach projects every day in all 50 states, and have done so for more than three decades with very few losses. We know how to safely and soundly introduce these opportunities to the capital markets. But, the GSEs are the missing link in the chain. I urge you to establish an Affordable Housing Fund that includes the Capital Magnet Fund in any GSE reform to allow us to make the GSEs our partners and to complete the chain.

Thank you again for the opportunity to speak today.

Community Development Financial Institutions Examples

Alabama. Cahaba Serves Calhoun and Jefferson Counties in Alabama, which includes the Birmingham metropolitan area Cahaba utilizes its New Markets Tax Credit (NMTC) allocation to provide equity and loans to commercial real estate projects, including retail, community service, office, for-sale housing, and light industrial/commercial service uses. The NMTC allocation enables Cahaba to offer products that are more favorable, including loans at below-market rates; and that the discount afforded by the NMTC will lead to lower rents in the low-income neighborhoods, thereby making commercial and retail users more capable of profit in its target location. (Birmingham, AL)

Colorado. Colorado Housing Enterprises, LLC (CHE) is a start-up CDFI with a mission of increasing home-ownership opportunities for low-income families in Alamosa, El Paso, and Routt Counties in Colorado. CHE used its $396,000 2005 financial assistance award from the CDFI Fund to expand its target market, develop new products, better track community development impacts, all resulting in better service to its clients. (Westminster, CO)

Connecticut. South Hartford Initiative has been providing home and business loans to one of the most economically disadvantaged areas of Hartford, CT. Efforts of the South Hartford Initiative have resulted in loans of $3.8 million dollars and additional leveraged capital of $8.4 million for 46 businesses in South Hartford. (Hartford, CT)

Delaware. The National Council on Agricultural Life and Labor Research Fund, Inc. (NCALL Research) was established nearly 50 years ago and provides financial and technical assistance for nonprofit housing developers in the Delmarva Peninsula. NCALL is a certified CDFI established in 1976. NCALL is a loan fund and a technical assistance and advocacy organization, assisting nonprofits in Delaware, Maryland, and Virginia in developing affordable rental and ownership housing for low-income households. NCALL used its 2006 CDFI Fund financial assistance award of $202,731 and a 2006 technical assistance award of $76,000 to expand its funding and technical assistance throughout the three states. (Dover, DE)

Florida. Established in 1994, Florida Community Loan Fund, Inc. (FCLF) provides loans and technical assistance to meet housing, economic development, and social service financing needs in low-income communities throughout Florida. Established in 1994, the Florida Community Loan Fund is a certified CDFI. It provides financing and technical assistance to nonprofit organizations working in low-income communities throughout the state. FCLF will use the FY07 financial assistance award to recapitalize its loan fund and for loans to build or rehabilitate affordable housing and community facilities. (Orlando, FL)

Hawaii. Hawaii First Federal Credit Union is a low-income designated credit union serving low-income residents on the island of Hawaii since 1956. It currently has a main office and one branch and is planning to open a third branch in Hilo, Hawaii. Hawaii First offers savings and loan products that meet the needs of the low-income targeted population across the state including a responsible payday loan product and a home construction loan in partnership with the state Department of Housing. (Kamuela, HI)

Idaho. Incorporated in June 2000, the Idaho-Nevada Community Development Financial Institution (INCDFI) provides business loans and affordable housing development financing to Investment Areas in the states of Idaho and Nevada INCDFI is a certified CDFI, established to enhance the economic independence and halt community deterioration in rural Idaho and Nevada by providing financing for small locally owned business, affordable housing development, and community infrastructure projects. The 2006 CDFI Fund financial assistance award of $246,500 will allow IINCDFI to leverage additional sources of financing and, over the next three years, nearly double the size of its loan portfolio, increase affordable rental units, and create jobs in low-income communities. (Pocatello, ID)

Indiana. The National Housing Trust Community Development Fund (NHTCDF), an affiliate of the National Housing Trust, provided a predevelopment loan to Lafayette Neighborhood Housing Services (LNHS) to help preserve and convert a historic school house into affordable apartments for seniors living in Lafayette, Indiana. In addition to the new apartments, the building includes

12,000 square feet of commercial space that will house homeownership and home maintenance workshops for LNHS. Converting this recently abandoned high school to affordable rental homes was integral to Lafayette efforts to restore the surrounding neighborhood. The city, local school district, and many local community organizations supported this adaptive re-use facility. (Lafayette, IN)

Kentucky. The Federation of Appalachian Housing Enterprise, Inc. (FAHE) is a certified CDFI that was established in 1980, and provides financial and development assistance to members providing affordable housing to low-income families and individuals in rural Appalachia, specifically in the states of Kentucky, Tennessee, Virginia, and West Virginia. FAHE is a certified CDFI established in 1981. FAHE provides an array of financial services including conventional mortgage products offered directly to consumers, and specialty mortgage products offered through its network. (Berea, KY)

Montana. Montana Homeownership Network (MHN) is a start-up CDFI incorporated in 2001 to serve low-income families and residents of distressed communities throughout the state of Montana. MHN provides homeownership counseling and brokers a number of first and second mortgage programs from its parent (Neighborhood Housing Services of Great Falls). MHN provides homeownership loans and developmental services to a low-income targeted population in Montana. MHN will use its FY07 CDFI Fund technical assistance award to: 1) obtain consulting services to evaluate new products and staffing needs; develop a capitalization strategy, and conduct a market analysis in assigned counties and 2) purchase presentation materials. (Great Falls, MT)

Nebraska. Community Development Resources, a certified CDFI established in 2000, provides financial and technical assistance related to business and housing development Lincoln, Nebraska. CDR provides microloans, small business loans, and community development loans. CDR will use its FY07 CDFI Fund financial assistance award to expand its business lending throughout Nebraska and to support its loan loss reserves. (Lincoln, NE)

New Jersey. The Community Loan Fund of New Jersey (CLFNJ) provides short-term loans and development services to nonprofits for the purpose of affordable single- and multi-family housing development. CLFNJ expects to create community development impacts of 750 multi-family housing units developed or rehabilitated, and 375 single-family housing units developed or rehabilitated with its award from the CDFI Fund. (Trenton, NJ)

New York. AAFE Community Development Fund provides financing and homeownership counseling primarily to Asian-American immigrants throughout New York City. In 2000, the Asian Americans for Equity, Inc. created the Community Development Fund (AAECDF). AAECDF is a certified CDFI and offers an array of services to Asian Americans living in the New York City metropolitan area. It offers such services as: 1) second mortgage purchase loans; 2) First Home Club IDAs; 3) down payment assistance to first-time homebuyers; and 4) rehabilitation and emergency repair loans. AAFECDF will use its FY07 CDFI Fund financial assistance award for homeownership loans in its target market and its technical assistance award for outreach, homeownership counseling, and marketing materials. (New York, NY)

North Carolina. Launched in 1980, Self-Help Credit Union is a federally insured, state regulated depository institution. Self-Help provides home and business ownership financing, targeting low-income, rural, women, and minority borrowers. The recent $1,398,750 financial assistance award from the CDFI Fund will be used to provide homeownership loans in North Carolina. Self-Help Credit Union is a certified CDFI and has been providing financing services since 1984. Its target market consists of low-income African Americans and Latinos in North Carolina and the Washington, DC metropolitan area. (Durham, NC)

Ohio. The Cincinnati Development Fund (CDF) provides loans and investments to induce financing activities to improve the economically distressed neighborhoods known as "Uptown Cincinnati" (Avondale, Clifton Heights, Corryville and Mt. Auburn). Created in 1988, CDF is a certified CDFI, nonprofit lending institution. It was established to provide loans to finance affordable housing development and community revitalization in the Greater Cincinnati Area. CDF will use its FY07 CDFI Fund financial assistance award to address foreclosures within its target market. The technical assistance grant will be used to support the staff's professional development, develop new products and services, and redesign its website. (Cincinnati, OH)

Pennsylvania. Founded in 1992, Community First Fund (CFF) is a nonprofit loan fund that serves businesses and residents in a 13 county area of central Pennsylvania with a population over three million people. CFF, established in 1992, is a nonprofit economic development loan fund and a certified CDFI. These counties include rural areas, small towns, urban centers, and surrounding suburban communities, which encompasses many distressed and underserved areas. CFF will use its FY07 CDFI Fund financial assistance award to meet the growing demand for commercial real estate loans. (Lancaster, PA)

Rhode Island. West Elmwood Housing Development Corporation (WEHDC) is a nonprofit housing loan fund that serves an urban market in southwestern Rhode Island. WEHDC provides lending and development services to improve housing for low-income people and spur economic activity in its target market of Providence County, RI. The WEHDC uses the CDFI Fund financial assistance to provide loans to more first-time homeowners and increase the number of home rehabilitation loans provided. (Providence, RI)

South Dakota. Dakotas America, LLC provide debt and equity capital to support emerging businesses in North Dakota and South Dakota in the energy, food/commodity processing, technology, retail service, health care and tourism sectors. Its service area includes regional Native American reservations, areas of extreme rural out-migration, EZ/EC communities, and low-income communities that exhibit some of the nation's most adverse economic conditions. The NMTCs are used to create loans that offer significantly lower rates, and other more favorable terms such as higher loan-to-value ratios, unsecured status, lower solvency requirements, extended maturity or reduced payments, and "quasi-equity" characteristics in support of gap financing. (Sioux Falls, SD)

Tennessee. Chattanooga Neighborhood Enterprises (CNE) was formed in 1986 to develop, finance, renovate, and manage affordable housing for low- and moderate-income families in Chattanooga, Tennessee. CNE operates four basic programs: development of affordable housing, property management, home improvement loans, and homeownership loans. It provides second mortgages, home improvement loans, education, and counseling to low-income residents in an effort to curb predatory lending in its target market. CNE will use the FY07 CDFI Fund financial assistance award to increase lending in its second mortgage portfolio. It will use the FY07 CDFI Fund technical assistance grant to hire an outreach and loan counselor who will assist help low-income households become homeowners. (Chattanooga, TN)

Utah. The Intermountain Tribal Alliance (ITA) of Salt Lake City, UT is a nonprofit corporation devoted to the economic and cultural development of Native American peoples in the United States. Chartered in 2000 in the State of Utah, ITA has used its CDFI Fund technical assistance grant of $95,000 from the 2005 Native American CDFI Assistance Program to create a CDFI focusing on community development venture capital. This Native CDFI provides seed money in the form of equity while bringing real understanding of tribal-owned company best practice using the prototype developed with the Northwestern Band of the Shoshone Nation in Utah. (Salt Lake City, UT)

Wyoming. Wind River Development Fund is a nonprofit business loan fund based in Fort Washakie, WY on the Wind River Indian Reservation. Its mission is to provide financial opportunities to stimulate economic development on the Wind River Reservation. WRDF provides small business loans and entrepreneurship development technical assistance to members of the Eastern Shoshone and Northern Arapaho Tribes. WRDF also assists clients with savings for business start-up through an IDA program. (Fort Washakie, WY)

Nancy O. Andrews has been the President and Chief Executive Officer of the Low Income Investment Fund (LIIF) since 1998. LIIF is a community development financial institution, dedicated to poverty alleviation. LIIF has access to capital resources totaling over $500 million, which it invests in community projects serving very low-income households. Nearly three-fourths of LIIF's financing serves families that are very-low income or extremely low-income. Ms. Andrews serves on numerous board and committees of community development and environmental organizations, including the National Housing Partnership Network, the Opportunity Finance Network, the National Low Income Housing Coalition, the Community Reinvestment Fund, the International Center for Forestry Research, and others. Ms. Andrews' background spans 30 years in the community development field.